

PAPER –1: FINANCIAL REPORTING

PART I

RELEVANT AMENDMENTS, NOTIFICATIONS AND ANNOUNCEMENTS

A. Applicable for May, 2020 Examination

1. The Companies (Indian Accounting Standards) Second Amendments Rules, 2019 notified on 30th March, 2019

Headings	Details
Appendix C, Uncertainty over Income Tax Treatments, to Ind AS 12	<p>MCA has inserted a new Appendix C to Ind AS 12, <i>Uncertainty over Income Tax Treatments</i>. The appendix explains how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment. In particular, it discusses:</p> <ul style="list-style-type: none">➤ how to determine the appropriate unit of account, and that each uncertain tax treatment should be considered separately or together as a group, depending on which approach better predicts the resolution of the uncertainty;➤ that the entity should assume a tax authority will examine the uncertain tax treatments and have full knowledge of all related information, i.e. detection risk should be ignored;➤ that the entity should reflect the effect of the uncertainty in its income tax accounting when it is not probable that the tax authorities will accept the treatment;➤ that the impact of the uncertainty should be measured using either the most likely amount or the expected value method, depending on which method better predicts the resolution of the uncertainty; and➤ that the judgements and estimates made must be reassessed whenever circumstances have changed or there is new information that affects the judgements.
Amendments to Ind AS 12 – Income tax consequences of payments on financial	<p>The amendments clarify that the income tax consequences of dividends on financial instruments classified as equity should be recognised according to where the past transactions or events that generated distributable profits were recognised. These requirements apply to all income tax consequences of dividends. Previously, it was unclear</p>

instruments classified as equity	whether the income tax consequences of dividends should be recognised in profit or loss, or in equity, and the scope of the existing guidance was ambiguous
Amendments to Ind AS 19 – Plan amendment, curtailment or settlement	<p>The amendments to Ind AS 19 clarify the accounting for defined benefit plan amendments, curtailments and settlements. They confirm that entities must:</p> <ul style="list-style-type: none"> ➤ calculate the current service cost and net interest for the remainder of the reporting period after a plan amendment, curtailment or settlement by using the updated assumptions from the date of the change; ➤ any reduction in a surplus should be recognised immediately in profit or loss either as part of past service cost, or as a gain or loss on settlement. In other words, a reduction in a surplus must be recognised in profit or loss even if that surplus was not previously recognised because of the impact of the asset ceiling; and ➤ separately recognise any changes in the asset ceiling through other comprehensive income.
Amendments to Ind AS 23 – Borrowing costs eligible for capitalisation	In computing the capitalisation rate for generally borrowed funds, the entity should exclude borrowing costs on borrowings which are specifically used for the purpose of obtaining a qualifying asset until that specific asset is ready for its intended use or sale. Once such specific asset is ready for its intended use or sale, borrowing costs related to borrowings of such asset shall be considered as part of general borrowing costs of the entity and be used for computation of capitalisation rate on general borrowings.
Amendment to Ind AS 28 – Long-term Interests in Associates and Joint Ventures	<p>An entity's net investment in associate or joint venture includes investment in ordinary shares, other interests that are accounted using the equity method, and other long term interests, such as preference shares and long term receivables or loans, the settlement of which is neither planned nor likely to occur in the foreseeable future. These long term interests are not accounted for in accordance with Ind AS 28, instead they are governed by the principles of Ind AS 109.</p> <p>As per para 10 of Ind AS 28, the carrying amount of entity's investment in its associate and joint venture increases or decreases (as per equity method) to recognise the entity's share of profit or loss of its investee associate and joint venture.</p>

	<p>Para 38 of Ind AS 38 further states that the losses that exceed the entity's investment in ordinary shares are applied to other components of the entity's interest in the associate or joint venture in the reverse order of their superiority.</p> <p>In this context, the amendments to Ind AS 28 clarify that the accounting for losses allocated to long-term interests would involve the dual application of Ind AS 28 and Ind AS 109. The annual sequence in which both standards are to be applied can be explained in a three step process:</p> <p>Step 1: Apply Ind AS 109 independently Apply Ind AS 109 (such as impairment, fair value adjustments etc.) ignoring any adjustments to carrying amount of long-term interests under Ind AS 28 (such as allocation of losses, impairment etc.)</p> <p>Step 2: True-up past allocations If necessary, prior years' Ind AS 28 loss allocation is trued up in the current year, because Ind AS 109 carrying value may have changed. This may involve recognizing more prior year's losses, reversing these losses or re-allocating them between different long-term interests.</p> <p>Step 3: Book current year equity share Any current year Ind AS 28 losses are allocated to the extent that the remaining long-term interest balance allows. Any current year Ind AS 28 profits reverse any unrecognized prior years' losses and then allocations are made against long-term interests.</p>
Amendment to Ind AS 103 – Control over a joint operation achieved in stages	When a party to a joint operation, obtains control of a joint operation business, the transaction will be considered as a business combination achieved in stages. The acquirer should re-measure its previously held interest in the joint operation at fair value at the acquisition date.
Amendment to Ind AS 109 – Prepayment Features with Negative Compensation	<p>Some prepayment options could result in other party being forced to accept negative compensation – e.g. the lender receives an amount less than the unpaid amounts of principal and interest if the borrower chooses to prepay.</p> <p>Earlier, these instruments were measured at FVTPL. However, now after amendment, such financial assets could be measured at amortised cost or at FVOCI if they meet the other relevant requirements of Ind AS 109. In other words, to qualify for amortised cost measurement,</p>

	<p>the negative compensation must be 'reasonable compensation for early termination of the contract' and the asset must be held within a 'held to collect' business model.</p> <p>To be eligible for the exception, the fair value of the prepayment feature would have to be insignificant on initial recognition of the asset. If this is impracticable to assess based on the facts and circumstances that existed on initial recognition of the asset, then the exception would not be available. Also financial assets prepayable at current fair value would be measured at FVTPL.</p>
Amendment to Ind AS 111 – Joint control over a joint operation achieved in stages	The amendments clarify that the entity, who is a party to joint operation but was not having joint control earlier, now obtains joint control of a business that is a joint operation should not re-measure its previously held interest in the joint operation.

2. Amendment in Schedule III notified by MCA on 12.10.2018

Following amendments have been made in Schedule III to the Companies Act, 2013

(a) In Division I which covers formats and instructions for financial statements drawn as per Accounting Standards ie Indian GAAP

Following amendments have been made

- (i) Clause (ii) of paragraph 4 under 'General instructions for preparation of Balance Sheet and statement of Profit and Loss of a company', states uniform use of unit of measurement in the financial statements. In the given sentence the word 'shall' has been replaced with the word 'should' through this notification. Hence, now the clause (ii) of paragraph 4 shall be read as follows:
*"Once a unit of measurement is used, it **should** be used uniformly in the Financial Statements."*
- (ii) Underneath Part I in the format of Balance Sheet, under the heading "II Assets" sub-heading "Non-current assets", **the words "Fixed assets" should be replaced as "Property, Plant and Equipment"**. This amendment has been done since the title of revised AS 10 is now 'Property, Plant and Equipment' instead of 'Fixed Assets'.
 Similar substitution has been done in Point W of the "Notes" under the heading "General Instructions for preparation of Balance Sheet".
- (iii) Point 6B of the "Notes", under the heading "General Instructions for preparation of Balance Sheet" deals with the classification of Reserves and

Surplus. One of the category was 'Securities Premium Reserve'. As per the amendment the word 'Reserve' after Securities Premium has been omitted. Now it should be read as '**Securities Premium**' only.

(b) In Division II which covers formats and instructions for financial statements drawn as per Indian Accounting Standards ie Ind AS

Following amendments have been made

- (i) In Part I which specifies the format of Balance Sheet, under the heading 'Equity and Liabilities', Trade Payables (both under 'non-current liabilities' and 'current liabilities') shall further be classified as
 - “(A) total outstanding dues of micro enterprises and small enterprises; and
 - (B) total outstanding dues of creditors other than micro enterprises and small enterprises.”;
- (ii) In the table (format) for 'Other Equity' under the 'Statement of Changes in Equity', "Securities Premium Reserve" is substituted as "Securities Premium". Also below the table on 'Other Equity' a note has been given which shall be renumbered as '(i)' and further a note has been added as follows:
 - “(ii) A description of the purposes of each reserve within equity shall be disclosed in the Notes.”
- (iii) Paragraph 6A and 6B of "General Instructions for Preparation of Balance Sheet" is on 'Non-current assets' and 'current assets' respectively.
 - (A) Under point 'VII. Trade Receivables' of 6A and 'III. Trade Receivables' of 6B, sub point (i) has been substituted as follows:
 - “(i) Trade Receivables shall be sub-classified as:
 - (a) Trade Receivables considered good - Secured;
 - (b) Trade Receivables considered good - Unsecured;
 - (c) Trade Receivables which have significant increase in Credit Risk; and
 - (d) Trade Receivables - credit impaired.”
 - (B) Under point 'VIII. Loans' of 6A and 'V. Loans' of 6B, sub point (ii) is substituted as follows:
 - “(ii) Loans Receivables shall be sub-classified as:
 - (a) Loans Receivables considered good - Secured;
 - (b) Loans Receivables considered good - Unsecured;

- (c) *Loans Receivables which have significant increase in Credit Risk; and*
- (d) *Loans Receivables - credit impaired,”*
- (iv) After paragraph F of “General Instructions for Preparation of Balance Sheet” paragraph FA shall be inserted as follows:

“FA. Trade Payables

The following details relating to micro, small and medium enterprises shall be disclosed in the notes:

- (a) *the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;*
- (b) *the amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006), along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;*
- (c) *the amount of interest due and payable for the period of delay in making payment (which has been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;*
- (d) *the amount of interest accrued and remaining unpaid at the end of each accounting year; and*
- (e) *the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.*

Explanation- *The terms ‘appointed day’, ‘buyer’, ‘enterprise’, ‘micro enterprise’, ‘small enterprise’ and ‘supplier’, shall have the same meaning as assigned to them under clauses (b), (d), (e), (h), (m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.”*

- (v) In paragraph 9, after the words “For instance,”, the words “plain vanilla” has been inserted. This amendment has been done to bring clarity to the treatment of redeemable preference shares ie which redeemable preference shares should fall in the category of ‘borrowings’. Accordingly, the last sentence of para 9 will be read as follows:

*“For instance, **plain vanilla** redeemable preference shares shall be classified and presented under 'non-current liabilities' as 'borrowings' and the disclosure*

requirements in this regard applicable to such borrowings shall be applicable mutatis mutandis to redeemable preference shares.”

(c) Division III (newly notified division applicable for NBFCs)

Through this notification, MCA added/notified Division III in the Schedule III which is applicable to Non-Banking Financial Company (NBFC) whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. **However, this Division III has not been made applicable for CA Final Students.**

3. Amendment in Ind AS 20 notified by MCA in the Companies (Indian Accounting Standards) Second Amendment Rules, 2018 on 20th September 2018

Amendment has been made in Ind AS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’. The amendment provides entities the option for recording non-monetary government grants at a nominal amount and presenting government grants related to assets by deducting the grant from the carrying amount of the asset.

4. Notification of Ind AS 115 and withdrawal of Ind AS 11 and Ind AS 18 alongwith the consequential amendments in other Ind AS and other amendments notified in the Companies (Indian Accounting Standards) Second Amendment Rules, 2018 on 28th March, 2018

The Rules have brought in the following significant amendments to Ind AS:

- New revenue standard Ind AS 115 has been notified which supersedes Ind AS 11, Construction Contracts and Ind AS 18, Revenue. (Refer Annexure IV for overview of Ind AS 115)
- Appendix B, Foreign Currency Transactions and Advance Consideration to Ind AS 21, The Effects of Changes in Foreign Exchange Rates has been notified. The appendix applies where an entity either pays or receives consideration in advance for foreign currency-denominated contracts. The date of the transaction determines the exchange rate to be used for initial recognition of the related asset, expense or income. Ind AS 21 requires an entity to use the exchange rate at the ‘date of the transaction’, which is defined as the date when the transaction first qualifies for initial recognition.

Here, the question arises that whether the date of the transaction is the date when the asset, expense or income is initially recognised, or an earlier date on which the advance consideration is paid or received, resulting in recognition of a prepayment or deferred income.

The appendix provides guidance for when a single payment/receipt is made, as well as for situations where multiple payments/receipts are made.

- **Single payment/receipt** The appendix states that the date of the transaction, for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income, should be the date on which an entity initially recognises the non-monetary asset or liability arising from an advance consideration paid/received.
- **Multiple receipts/payments** The appendix states that, if there are multiple payments or receipts in advance of recognising the related asset, income or expense, the entity should determine the date of the transaction for each payment or receipt.
- Amendment to Ind AS 40, Investment Property stating that when assets are transferred to, or from, investment properties. The amendment states that to transfer to, or from, investment properties there must be a change in use supported by evidence. A change in intention, in isolation is not enough to support a transfer. The amendment has re-described the list of evidence of change in use as a non-exhaustive list of examples and scope of these examples have been expanded to include assets under construction and development and not only transfers of completed properties.
Examples of evidence of a change in use include:
 - a) commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;
 - b) commencement of development with a view to sale, for a transfer from investment property to inventories;
 - c) end of owner-occupation, for a transfer from owner-occupied property to investment property;
 - d) inception of an operating lease to another party, for a transfer from inventories to investment property.
- Amendments to Ind AS 12, Income Taxes elucidate the existing guidance in Ind AS 12. They do not change the underlying principles of recognition of deferred tax asset. As per the amendment:
 - Existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period and is not affected by possible future changes in the carrying amount. Consequently, decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value in the books of the holder for which the tax base remains at cost gives rise to a deductible temporary difference. This is regardless of whether the holder expects to collect all the contractual cash flows of the debt instrument.

- Determining the existence and amount of temporary differences and estimating future taxable profit against which deferred tax assets can be utilised are two separate steps. Recovering assets for more than their carrying amounts is inherent in an expectation of taxable profits and should therefore be included in estimated taxable profit if there is sufficient evidence to conclude that it is probable that the entity will recover the asset for more than its carrying amount. For example, an entity should assume that a debt investment measured at fair value will be recovered for more than its carrying value when that outcome is probable even if carrying value is below its tax base (original investment cost).
- Recoverability of deferred tax assets are assessed in combination with other deferred tax assets where the tax law does not restrict the source of taxable profits against which particular types of deferred tax assets can be recovered. Where restrictions apply (for example where capital losses can be set off against capital gains), deferred tax assets are assessed in combination only with other deferred tax assets of the same type.
- When comparing deductible temporary differences against future taxable profits, the determination of future taxable profits shall exclude tax deductions resulting from reversal of these deductible temporary differences.
- Amendment to Ind AS 28, Investments in Associates and Joint Ventures and Ind AS 112, Disclosure of Interests in Other Entities stating that:
 - Disclosures requirement of Ind AS 112 are applicable to interest in entities classified as held for sale except for summarised financial information (para B17 of Ind AS 112).
 - In Ind AS 28, the option available with venture capital organisations, mutual funds, unit trusts and similar entities to measure their investments in associates or joint ventures at fair value through profit or loss (FVTPL) is available for each investment in an associate or joint venture.
- Consequential amendments to other Ind AS due to notification of Ind AS 115 and other amendments discussed above
 - (i) **Ind AS 101, First-time Adoption of Indian Accounting Standards:** The Rules introduce two additional exemptions in Ind AS 101 related to Ind AS 115 and Appendix B to Ind AS 21. These are:
 - Ind AS 115: A first-time adopter can apply the transition provisions in paragraphs C5 and C6 of Ind AS 115 (related to practical expedients when applying Ind AS 115 retrospectively) at the date of transition to Ind AS. Further, a first-time adopter is not required to restate contracts that were completed before the earliest period presented.

- Appendix B to Ind AS 21: A first-time adopter need not apply Appendix B to Ind AS 21 to assets, expenses and income in the scope of the appendix initially recognised before the date of transition to Ind AS.
- (ii) **Ind AS 2, Inventories**: Costs of services by a service provider that does not give rise to inventories will need to be accounted for as costs incurred to fulfil a contract with customer in accordance with Ind AS 115. Such costs can be capitalised under Ind AS 115 if they
 - (1) relate directly to the contract,
 - (2) enhance the resources of the entity to perform under the contract and relate to satisfying a future performance obligation, and
 - (3) are expected to be recovered.

Earlier paragraph 8 of Ind AS 2 which stated that in case of a service provider, inventories include costs of the service, for which the entity has not yet recognised the related revenue, has been deleted.
- (iii) **Ind AS 16, Property, Plant and Equipment, Ind AS 38, Intangible Assets and Ind AS 40, Investment Property**: These standards have been amended to require use of principles of Ind AS 115 for recognition of a gain or loss on the transfer of non-financial assets i.e. property, plant and equipment, intangible asset and investment property, that are not an output of an entity's ordinary activities. Although a gain or loss on this type of sale generally does not meet the definition of revenue, an entity should apply the guidance in Ind AS 115 related to the transfer of control and measurement of the transaction price including the constraint on variable consideration, to evaluate the timing and amount of the gain or loss recognised.

Further, since Ind AS 115 deals with accounting for contract assets, Ind AS 38 has been amended to add a scope exclusion for such contract assets.
- (iv) **Ind AS 37, Provisions, Contingent Assets and Contingent Liabilities**: Ind AS 115 does not have any specific requirement to address the accounting of contracts with customers that are, or have become, onerous. Previously, depending upon type of contract, such onerous contracts were accounted under Ind AS 11 or Ind AS 37. With the omission of Ind AS 11, a consequential amendment has been made to Ind AS 37 to bring all onerous revenue contracts within the scope of the Ind AS 37. Ind AS 37 defines onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.
- (v) **Ind AS 109, Financial Instruments**: Amendments to Ind AS 109 are discussed below:

- (i) The current Ind AS 109 states that an entity shall measure trade receivables at their transaction price. Due to notification of Ind AS 115, an entity is required to measure trade receivables at their transaction price if the trade receivables do not contain a significant financing component in accordance with Ind AS 115.
- (ii) An entity shall have an accounting policy choice to measure loss allowance on trade receivables or contracts assets within the scope of Ind AS 115 containing a significant financing component at an amount equal to life time expected credit losses (simplified approach) or using the general model (3 stage).
- (iii) Entities shall now consider the principles of Ind AS 115 for subsequent measurement of financial guarantee and loan commitments.

5. Applicability of Amendments to Ind AS 7 and Ind AS 102 issued by the MCA dated 17th March 2017

To align Ind AS with IFRS, the recent amendments made in IAS 7 and IFRS 2 by the IASB have been incorporated in Ind AS 7 'Statement of Cash Flows' and Ind AS 102 'Share-based Payment' by way of a notification issued by the Ministry of Corporate Affairs on 17th March, 2017.

I. Amendments in Ind AS 7 'Statement of Cash Flows'- Disclosure requirements

The amendments made to Ind AS 7 require certain additional disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

In addition to the above, the disclosure is required for changes in financial assets (for example, assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.

As per the amendment, one of the way for disclosure is providing a reconciliation between the opening and closing balances in the balance sheet for liabilities arising from financing activities, including the changes identified, by linking items included in the reconciliation to the balance sheet and the statement of cash flows for the sake of information to the users.

If an entity provides disclosures of changes in other assets and liabilities besides changes in liabilities arising from financing activities, it shall disclose the later changes separately from changes in those other assets and liabilities.

II. Amendments in Ind AS 102 'Share-based Payment'

The amendments cover following accounting areas:

Measurement of cash-settled share-based payments

Under Ind AS 102, the measurement basis for an equity-settled share-based payment should not be 'fair value' in accordance with Ind AS 113, 'Fair value measurement'. However, 'fair value' was not defined in connection with a cash-settled share-based payment. The amendment clarifies that the fair value of a cash-settled award is determined on a basis consistent with that used for equity-settled awards. Market-based performance conditions and non-vesting conditions are reflected in the 'fair value', but non-market performance conditions and service conditions are reflected in the estimate of the number of awards expected to vest.

The amendment to Ind AS 102 with respect to measurement of cash-settled awards has most impact where an award vests (or does not vest) based on a non-marketing condition. Absent this clarification, it may be argued that the fair value of a cash-settled award is to be determined using the guidance in Ind AS 113 and reflecting the probability that non-market and service vesting conditions would be met. The amendment clarifies that non-market and service vesting conditions are ignored in the measurement of fair value.

Classification of share-based payments settled net of tax withholdings

Tax laws or regulations may require the employer to withhold some of the shares to which an employee is entitled under a share-based payment, and to remit the tax payable on it to the tax authority.

Ind AS 102 would require such share based payment to be split into a cash settled component for the tax payment and an equity settled component for the net shares issued to the employee. The amendment now adds an exception that requires the share based payment to be treated as equity-settled in its entirety. The cash payment to the tax authority is treated as if it was part of an equity settlement. The exception would not apply to any equity instruments that the entity withholds in excess of the employee's tax obligation associated with the share-based payment.

Accounting for a modification of a share-based payment from cash-settled to equity-settled

As per the amendment, if the terms and conditions of a cash-settled share-based payment transactions are modified with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as such from the date of the modification. Specifically:

- o The equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted at the modification date. The equity-settled share-based payment transaction is recognised in equity on the modification date to the extent to which goods or services have been received.
- o The liability for the cash-settled share-based payment transaction as at the modification date is derecognised on that date.

- o Any difference between the carrying amount of the liability derecognised and the amount of equity recognised on the modification date is recognised immediately in profit or loss.
 - o The amendment requires any change in value to be dealt with before the change in classification. Accordingly, the cash-settled award is remeasured, with any difference recognised in the statement of profit and loss before the remeasured liability is reclassified into equity.
6. **Notification of Ind AS 116 and withdrawal of Ind AS 17 alongwith the consequential amendments in other Ind AS and other amendments notified in the Companies (Indian Accounting Standards) Second Amendment Rules, 2018 on 30th March, 2019.**

(Refer Annexure V for overview of Ind AS 116)

Annexure IV

Overview of Ind AS 115 “Revenue from Contracts with Customers”

The objective of Ind AS 115 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

The standard applies to all contracts with customers, except the lease contracts within the scope of Ind AS 17, Leases; insurance contracts within the scope of Ind AS 104, Insurance Contracts; financial instruments and other contractual rights or obligations; and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

The core principle of Ind AS 115 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue shall be recognised by an entity in accordance with this core principle by applying the following five steps:

1. **Identify contract with a customer:** This Standard defines a ‘contract’ and a ‘customer’ and specifies five mandatory criteria to be met for identification of a contract.
2. **Identify performance obligations in contract:** At contract inception, assess the goods or services promised and identify as a performance obligation each promise to transfer to the customer either:
 - (a) a good or service (or a bundle of goods or services) that is distinct; or
 - (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

3. **Determine transaction price:** This Standard uses transaction price approach instead of fair value approach in Ind AS 18 while determining amount of consideration. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised may include fixed amounts, variable amounts, or both. If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. Estimate amount of variable consideration by using either the expected value method or the most likely amount method. The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component for any consideration payable to the customer.
4. **Allocate the transaction price to the performance obligations in the contract:** An entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract. If a stand-alone selling price is not observable, an entity estimates it. Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract. The requirements specify when an entity allocates the discount or variable consideration to one or more, but not all, performance obligations in the contract. Any subsequent changes in the transaction price shall be allocated to the performance obligations on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.
5. **Recognise revenue when the entity satisfies a performance obligation:** An entity recognises revenue when it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time or over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. For performance obligations satisfied over time, an entity recognises revenue over time by selecting an appropriate method (output methods and input methods) for measuring the entity's progress towards complete satisfaction of that performance obligation.

Treatment of Contract Costs

Ind AS 115 specifies the following requirements for contract costs:

1. *Incremental costs of obtaining a contract:*

Those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. An entity shall recognise these costs as an asset if the entity expects to recover those costs. Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

2. *Costs to fulfil a contract:*

If costs incurred in fulfilling a contract are not within scope of another Standard, entity shall recognise an asset from the costs incurred to fulfil a contract only if some specified criteria are met. If costs incurred in fulfilling a contract are within scope of another Standard, entity shall account for those costs in accordance with those other Standards.

Contract costs recognised as an asset shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

An impairment loss shall be recognised in profit or loss to the extent that the carrying amount of contract costs recognised as an asset exceeds the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates after deducting the costs that relate directly to providing those goods or services and that have not been recognised as expenses.

Presentation

When either party to a contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment.

- If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (i.e. a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier).
- If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable.
- An entity shall present any unconditional rights to consideration separately as a receivable.

Sale with a right of return

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

- revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);

- a refund liability; and
- an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

Warranties

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

Principal versus agent considerations

When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for those goods or services to be provided by the other party (i.e. the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

Repurchase agreements

Repurchase agreements generally come in three forms viz. (i) an entity's obligation to repurchase the asset (a forward); (ii) an entity's right to repurchase the asset (a call option); and an entity's obligation to repurchase the asset at the customer's request (a put option).

Bill-and-hold arrangements

A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but retains physical possession of the product until it is transferred to the customer at a point in time in the future. Ind AS 115 specifies four criteria that must be fulfilled for a customer to have obtained control of a product in a bill-and-hold arrangement.

Disclosure

The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:

- its contracts with customers
- the significant judgements, and changes in the judgements, made in applying this Standard to those contracts and

- any assets recognised from the costs to obtain or fulfil a contract with a customer

Appendix D of Ind AS 115 gives guidance on the accounting by operators for public-to-private service concession arrangements. This Appendix applies to both (a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement. Infrastructure within the scope of this Appendix shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator.

Carve out in Ind AS 115 from IFRS 15

As per IFRS

IFRS 15 provides that all types of penalties which may be levied in the performance of a contract should be considered in the nature of variable consideration for recognising revenue.

Carve out

Ind AS 115 has been amended to provide that penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration, otherwise the same should not be considered for determining the consideration and the transaction price shall be considered as fixed.

Significant differences in Ind AS 115 from AS 7 and AS 9

S. No.	Particular	Ind AS 115	AS 7 and AS 9
1.	Framework of Revenue Recognition	Ind AS 115 gives a framework of revenue recognition within a standard. It specifies the core principle for revenue recognition which requires the 'revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services'.	AS 7 and AS 9 do not provide any such overarching principle to fall upon in case of doubt.
2.	Comprehensive Guidance on Recognition and Measurement of Multiple Elements within	Ind AS 115 gives comprehensive guidance on how to recognise and measure multiple elements within a contract with customer.	AS 7 and AS 9 do not provide comprehensive guidance on this aspect.

	a Contract with Customer:		
3.	Coverage	Ind AS 115 comprehensively deals with all types of performance obligation contract with customer. However, it does not deal with revenue from 'interest' and 'dividend' which are covered in financial instruments standard.	AS 7 covers only revenue from construction contracts which is measured at consideration received / receivable. AS 9 deals only with recognition of revenue from sale of goods, rendering of services, interest, royalties and dividends.
4.	Measurement of Revenue	As per Ind AS 115, revenue is measured at transaction price, i.e., the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.	As per AS 9, Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. As per AS 7, revenue from construction contracts is measured at consideration received / receivable and to be recognised as revenue as construction progresses, if certain conditions are met.
5.	Recognition of Revenue	As per Ind AS 115, revenue is recognised when the control is transferred to the customer.	As per AS 9, revenue is recognised when significant risks and rewards of ownership is transferred to the buyer. As per AS 7, revenue is recognised when the

			outcome of a construction contract can be estimated reliably, contract revenue should be recognised by reference to the stage of completion of the contract activity at the reporting date.
6.	Capitalisation of Costs	Ind AS 115 provides guidance on recognition of costs to obtain and fulfill a contract, as asset	AS 7 and AS 9 do not deal with such capitalisation of costs.
7.	Guidance on Service Concession Arrangements	Ind AS 115 gives guidance on service concession arrangements and disclosures thereof	AS does not provide such guidance.
8.	Disclosure Requirements	Ind AS 115 contains detailed disclosure requirements.	Less disclosure requirements are prescribed in AS

Annexure V

Overview of Ind AS 116 “Leases”

Objective

Ind AS 116 sets out the principles for the recognition, measurement, presentation and disclosure of leases and faithful representation of the transactions by lessees and lessors. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.

Scope

The standard applies to all leases, including leases of right-of-use assets in a sublease, except for:

- (a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- (b) Leases of biological assets within the scope of Ind AS 41, Agriculture held by a lessee;
- (c) Service concession arrangements within the scope of Appendix D, Service Concession Arrangements of Ind AS 115, Revenue from Contracts with Customer;
- (d) Licences of intellectual property granted by a lessor within the scope of Ind AS 115, Revenue from Contracts with Customers; and

- (e) Rights held by a lessee under licensing agreements within the scope of Ind AS 38, Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

A lessee may, but is not required to, apply Ind AS 116 to leases of intangible assets other than those described in point (e) above.

This Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements would not differ materially.

Recognition exemption

In addition to the above scope exclusions, a lessee can elect not to apply the recognition, measurement and presentation requirements of Ind AS 116 to short-term leases; and low value leases.

If a lessee elects for the exemption, then it shall recognise the lease payments associated with those leases as an expense on either a straight line basis over the lease term or another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

The election for short-term leases shall be made by class of underlying asset to which the right of use relates. The low value lease exemption can be applied on a lease-by-lease basis.

The assessment of whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for exemption regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach the same conclusions about whether a particular underlying asset is of low value.

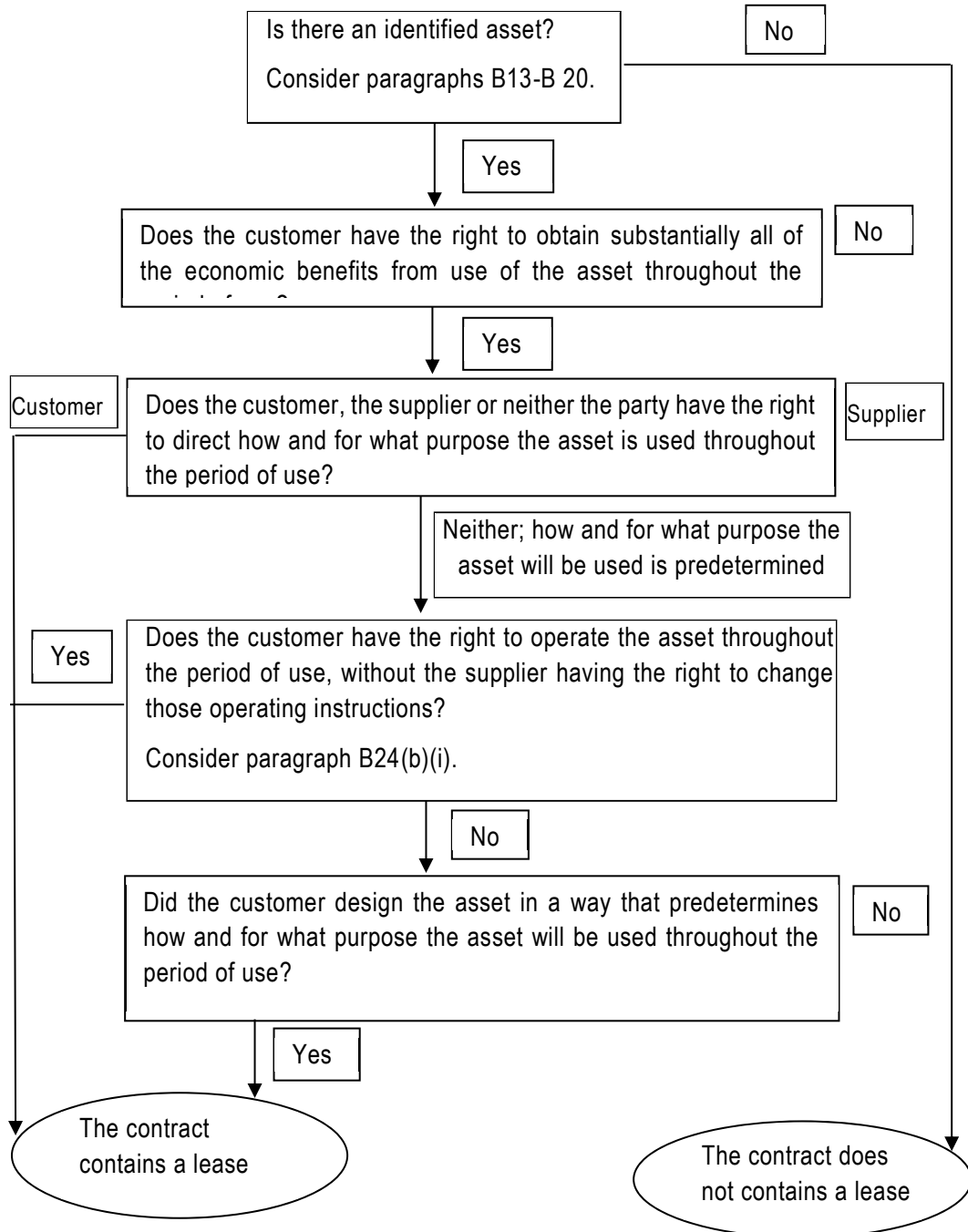
If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

If an entity applies either exemption, it must disclose that fact and certain information to make the effect of the exemption known to users of its financial statements. (Refer – Disclosure)

Identifying a lease

At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.



Separating component of contract

For a contract that contains a lease component, an entity accounts for each lease component within the contract separately from non-lease components. A lessee shall allocate the total contract consideration to each lease component on the basis of relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components. A lessee shall account for non-lease components applying other applicable Standards.

As a practical expedient, a lessee may elect not to separate non-lease components from the lease components. Instead it may account for the entire contract including non-lease components as a single lease component.

The practical expedient shall not be applied to embedded derivatives that meet the criteria given Ind AS 109, Financial Instruments.

Lease term

If a contract is, or contains, a lease, the lease term needs to be determined.

The lease term begins on the commencement date (i.e. the date on which the lessor makes the underlying asset(s) available for use by the lessee) and includes any rent-free or reduced rent periods. It comprises:

- (a) The non-cancellable period of the lease;
- (b) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- (c) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option

A lease is no longer enforceable when the lessee and the lessor each have the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

An entity shall revise the lease term if there is a change in the non-cancellable period of a lease.

Recognition and Measurement of lease in the books of Lessee

On the commencement of the lease, lessee needs to recognise the right-of use asset and measure it at cost. Lessee should also recognise a lease liability and measure it at the present value of the lease payments that are not paid at that date. The lease payments should be

discounted using the interest rate implicit in the lease, if readily determinable or else using the lessee's incremental borrowing rate.

$A\ Cost = Lease\ Liability + Lease\ payments\ made - lease\ incentives\ received + initial\ direct\ costs + estimated\ dismantling\ and\ restoration\ costs.$

$Lease\ Payments = Fixed\ payments\ (including\ in-substance\ fixed\ lease\ payments) - lease\ incentives + variable\ payments + expected\ guaranteed\ residual\ value + exercise\ price\ of\ purchase\ option\ (if\ reasonably\ certain\ to\ be\ exercised) + penalties\ for\ termination\ (if\ reasonably\ certain\ to\ be\ terminated).$

In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable.

Subsequent measurement

Subsequently, the right-of-use asset shall be measured by applying a cost model or revaluation model if the underlying asset belongs to the class of assets to which the entity applies revaluation model as per Ind AS 16, Property, Plant and Equipment.

Cost model

Lessee shall measure the right-of-use asset at cost less accumulated depreciation and any accumulated impairment losses.

Lessees adjust the carrying amount of the right-of-use asset for remeasurement of the lease liability, unless the carrying amount has already been reduced to zero or the change in the lease liability relates to a variable lease payment that does not depend on an index or rate.

Subsequent measurement of lease liability

After initial recognition, the lease liability is measured at amortised cost using the effective interest method and remeasuring the carrying amount to reflect any reassessment or lease modifications or to reflect revised in-substance fixed lease payments.

Reassessment of lease liability

After the commencement date, a lessee shall remeasure the lease liability in accordance with the standard to reflect changes to the lease payments. A lessee shall recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognise any remaining amount of the remeasurement in profit or loss.

Presentation

The right-of-use assets should be either presented separately from other assets in the balance sheet or disclosed in the notes. If not presented separately, they should be presented in the

appropriate line item of the balance sheet as if they were owned and disclose in the notes the line items which include such assets.

The lease liabilities should be presented either separately from other liabilities in the balance sheet or disclose in the notes the line items which include the lease liabilities.

Right-of-use assets that meet the definition of investment property are presented within investment property.

In the statement of profit and loss, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs requires to be presented separately in the statement of profit and loss.

In the statement of cash flows, a lessee shall classify:

- a) cash payments for the principal portion of the lease liability within financing activities;
- b) cash payments for the interest portion of the lease liability within financing activities applying the requirements in Ind AS 7, Statement of Cash Flows, for interest paid; and
- c) short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Accounting in the books of Lessor

Classification of leases

A lessor shall classify each of its leases as either an operating lease or a finance lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. The standard also provides examples of situations that individually or in combination would/could normally lead to a lease being classified as a finance lease.

Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

Finance lease and Operating lease**Recognition and measurement**

Particulars	Finance lease	Operating lease
Balance Sheet impact	Derecognised the underlying asset	Continue to present the underlying asset
	Present lease receivable at an amount equal to the net investment in lease	Add any initial direct costs incurred in connection with obtaining the lease to the carrying amount of the underlying asset
Statement of profit and loss	lessor shall recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease	Lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished
Statement of profit and loss: In case manufacturer or dealer is lessor	revenue being the fair value of the underlying asset, or, if lower, the present value of the lease payments accruing to the lessor, discounted using a market rate of interest	Recognise depreciation expense over the useful life of asset
	the cost of sale being the cost, or carrying amount if different, of the underlying asset less the present value of the unguaranteed residual value	
	selling profit or loss in accordance with its policy for outright sales to which Ind AS 115 applies	

A lessor initially measures a finance lease receivable at the present value of the future lease payments plus any unguaranteed residual value accruing to the lessor. The lessor discounts these amounts using the rate implicit in the lease.

A lessor includes the following lease payments in the measurement of the finance lease receivable:

- fixed payments (including in-substance fixed payments), less lease incentives payable;
- variable payments that depend on an index or rate;
- residual value guarantees provided to the lessor at the guaranteed amount;
- the exercise price of purchase options if the lessee is reasonably certain to exercise; and
- termination penalties payable in accordance with the expected lease term.

Presentation

Lessor shall present underlying assets subject to operating leases in its balance sheet according to the nature of the underlying asset.

Sale and lease back – recognition and measurement

Determine whether transfer of asset is a sale of that asset	
transfer of asset is a sale	transfer of asset is a not a sale
Transaction will be accounted for as a sale and a lease by both the lessee and the lessor.	Transaction will be accounted for as a financing arrangement by both the seller-lessee and the buyer-lessor
<u>Seller-lessee</u> <ul style="list-style-type: none"> ▮ Measure right-of-use asset at proportion of previous carrying amount of asset relating to right of-use asset retained by seller-lessee. ▮ Recognise only amount of gain or loss relating to rights transferred to buyer-lessor. <u>Buyer-lessor</u> <ul style="list-style-type: none"> ▮ Account for purchase of asset applying applicable standards. ▮ Account for lease applying lessor accounting requirements under Ind AS 116. 	<u>Seller-lessee</u> <ul style="list-style-type: none"> ▮ Continue to recognise transferred asset. ▮ Recognise financial liability equal to transfer proceeds applying Ind AS 109. <u>Buyer-lessor</u> <ul style="list-style-type: none"> ▮ Not recognise transferred asset. ▮ Recognise financial asset equal to transfer proceeds applying Ind AS 109.

Transition date accounting**Definition of lease**

On the date of initial application of Ind AS 116, companies have an option not to reassess its previously identified leases contracts (as per Ind AS 17, Leases) and apply the transition provisions of this standard to those leases.

Also, they have an option not to apply this Standard to contracts that were not previously identified as containing a lease applying Ind AS 17.

If an entity chooses the above options then it shall disclose that fact and apply the practical expedient to all of its contracts.

Transition accounting: In the books of Lessee

A lessee is permitted to:

- adopt the standard retrospectively; or
- follow a modified retrospective approach.

A lessee applies the election consistently to all of its leases.

Modified retrospective approach

Lessee shall not restate comparative information and recognise the cumulative effect of initially applying Ind AS 116 as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

For leases previously classified as operating leases and finance Leases, the following may be noted:

Operating lease	Lease liability	Measure at the present value of the remaining lease payments, discounted using lessee's incremental borrowing rate at the date of initial application
	Right-of-use asset	Retrospective calculation, using a discount rate based on lessee's incremental borrowing rate at the date of initial application. or Amount of lease liability (adjusted by the amount of any previously recognised prepaid or accrued lease payments relating to that lease).

		Lessee can choose one of the alternatives on a lease-by-lease basis.
Finance lease	Lease liability	Carrying amount of the lease liability immediately before the date of initial application.
	Right-of-use asset	Carrying amount of the lease asset immediately before the date of initial application.
	Application of Ind AS 116	Apply the provisions of this standard to Right of Use asset and lease liability from the date of initial application.

The standard also prescribes certain practical expedients under Modified retrospective approach to leases previously classified as operating leases applying Ind AS 17.

Transition accounting: In the books of Lessor

Except for sub-leases and sale-and-leaseback transactions, a lessor does not make any adjustments on transition:

Sales and leaseback transaction

Sale and leaseback transactions entered into before the date of initial application shall not be reassessed to determine whether the transfer of the underlying asset satisfies the requirements in Ind AS 115 to be accounted for as a sale.

For a sale-and-leaseback transaction accounted for as a sale and finance lease in accordance with Ind AS 17, the seller-lessee:

- ▢ accounts for the leaseback in the same way as for any finance lease that exists at the date of initial application; and
- ▢ continues to amortise any gain on the sale over the lease term

For a sale-and-leaseback transaction accounted for as a sale and operating lease in accordance with Ind AS 17, the seller-lessee:

- ▢ accounts for the leaseback in the same way as for any other operating lease that exists at the date of initial application; and
- ▢ adjusts the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the statement of financial position immediately before the date of initial application.

Major change in Ind AS 116 vis-à-vis IFRS 16 not resulting in carve out

1. With regard to subsequent measurement, paragraph 34 of IFRS 16 provides that if lessee applies fair value model in IAS 40 to its investment property, it shall apply that fair value model to the right-of use assets that meet the definition of investment property. Since Ind AS 40, Investment Property, does not allow the use of fair value model, paragraph 34 has been deleted in Ind AS 116.
2. Paragraph 50(b) of IFRS 16 requires to classify cash payments for interest portion of lease liability applying requirements of IAS 7, Statement of Cash Flows. IAS 7 provides option of treating interest paid as operating or financing activity. However, Ind AS 7 requires interest paid to be treated as financing activity only. Accordingly, paragraph 50(b) has been modified in Ind AS 116 to specify that cash payments for interest portion of lease liability will be classified as financing activities applying Ind AS 7.

Major Changes in Ind AS 116 vis-à-vis AS 19

S. No.	Particular	Ind AS 116	AS 19
1.	Lease definition	Under Ind AS 116, the definition of lease is similar to that in AS 19. But, in Ind AS 116, there is substantial change in the guidance of how to apply this definition. The changes primarily relate to the concept of 'control' used in identifying whether a contract contains a lease or not.	No such guidance given therein
2.	Modifications	Ind AS 116 brings in comprehensive prescription on accounting of modifications in lease contracts.	No such guidance given therein
3.	Scope:	Ind AS 116 has no such scope exclusion.	AS 19 excludes leases of land from its scope.
4.	Inception of lease and commencement of lease	Ind AS 116 makes a distinction between 'inception of lease' and 'commencement of lease'	No such distinction is there
5	Classification	Ind AS 116 eliminates the requirement of classification of leases as either operating leases or finance leases for a lessee and instead, introduces a single	AS 19 requires a lessee to classify leases as either finance leases or operating leases.

		lessee accounting model which requires lessee to recognise assets and liabilities for all leases unless it applies the recognition exemption applies.	
6	Sale & Leaseback transactions	In Ind AS 116, the approach for computation of gain/loss for a completed sale is different. The amount of gain/loss should reflect the amount that relates to the right transferred to the buyer-lessor.	As per AS 19, if a sale and leaseback transaction results in a finance lease, excess, if any, of the sale proceeds over the carrying amount shall be deferred and amortised by the seller-lessee over the lease term in proportion to depreciation of the leased asset.
		Ind AS 116 requires a seller-lessee and a buyer-lessor to use the definition of a sale as per Ind AS 115, Revenue from Contracts with Customers to determine whether a sale has occurred in a sale and leaseback transaction. If the transfer of the underlying asset satisfies the requirements of Ind AS 115 to be accounted for as a sale, the transaction will be accounted for as a sale and a lease by both the lessee and the lessor. If not, then the seller-lessee shall recognise a finance liability and the buyer-lessor will recognise a financial asset to be accounted for as per the requirements of Ind AS 109, Financial Instruments.	AS 19 does not contain such specific requirement.

7.	For lessor, the treatment of initial direct costs -Finance lease lessor accounting		
	Non-manufacturer/Non-dealer	Interest rate implicit in the lease is defined in such a way that the initial direct costs included automatically in the finance lease receivable.	Either recognised as expense immediately or allocated against the finance income over the lease term.
	Manufacturer/dealer	Same as per AS 19.	Recognised as expense immediately.
	Operating lease-Lessor accounting	Added to the carrying amount of the leased asset and recognised as expense over the lease term on the same basis as lease income.	Either deferred and allocated to income over the lease term in proportion to the recognition of rent income or recognized as expense in the period in which incurred.
8.	Interest rate implicit in the lease'	Definition of the term 'interest rate implicit in the lease' has been modified	Different definition given
9.	Presentation	As a consequence of introduction of single lease model for lessees, there are many changes in the presentation in the three components of financial statements viz. Balance sheet, Statement of P&L, Statement of Cash flows.	Difference in presentation requirement
10.	Disclosure	There are a number of changes in the disclosure relating to qualitative aspects of leasing transactions. For eg. Entities are required to disclose the nature and risks arising from leasing transactions. Also, in case of lessor, there are changes in the disclosure of maturity analysis of leases payments receivable.	Difference in disclosure requirement

PART – II : QUESTIONS AND ANSWERS
QUESTIONS

AS 2

1. (a) Kirti Ltd. is in the business of manufacturing computers. During the year ended 31st March, 20X1, the company manufactured 550 computers. It has the policy of valuing finished stock of goods at a standard cost of ₹ 1.8 lakh per computer. The details of the costs are as under:

	(₹ in lakh)
Raw material consumed	400
Direct Labour	250
Variable production overheads	150
Fixed production overheads (including interest of ₹ 100 lakh)	290

Compute the value of cost per computer for the purpose of closing stock and also comment on the policy of valuation of inventory adopted by Kirti Ltd.

AS 3

- (b) Purse Ltd., a non financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.
- (i) Loans and Advances given to the following and interest earned on them:
 - (1) to suppliers
 - (2) to employees
 - (3) to its subsidiaries companies
 - (ii) Investment made in subsidiary Wallet Ltd. and dividend received
 - (iii) Dividend paid for the year
 - (iv) TDS on interest income earned on investments made
 - (v) TDS on interest earned on advance given to suppliers
 - (vi) Insurance claim received against loss of property, plant and equipment by fire.
- Discuss in the context of AS 3 'Cash Flow Statement'.

AS 4

2. (a) For seven companies whose financial year ended on 31st March, 20X1, the financial statements were approved by their approving authority on 15th June, 20X1. During 20X1-20X2, the following material events took place:

- a. A Ltd. sold a major property which was included in the balance sheet at ₹ 1,00,000 and for which contracts had been exchanged on 15th March, 20X1. The sale was completed on 15th May, 20X1 at a price of ₹ 2,50,000.
- b. On 30th April, 20X1, a 100% subsidiary of B Ltd. declared a dividend of ₹ 3,00,000 in respect of its own shares for the year ended on 31st March, 20X1.
- c. On 31st May, 20X1, the mail order activities of C Ltd. (a retail trading group) were shut down with closure costs amounting to ₹ 2.5 million.
- d. On 1st July, 20X1 the discovery of sand under D Ltd.'s major civil engineering contract site causes the cost of the contract to increase by 25% for which there would be no corresponding recovery from the customer.
- e. A fire, on 2nd April, 20X1, completely destroyed a manufacturing plant of E Ltd. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.
- f. A claim for damage amounting to ₹ 8 million for breach of patent had been received by F Ltd. prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.
- g. The change in foreign exchange rate of 8% between 1st April, 20X1 and 1st June, 20X1 has resulted in G Ltd.'s foreign assets being reduced by ₹ 1.3 million.

You are required to state with reasons, how each of the above items numbered (a) to (g) should be dealt with in the financial statement of the various companies for the year ended 31st March, 20X1.

AS 5

- (b) Explain whether the following will constitute a change in accounting policy or not as per AS 5:
 - (i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.
 - (ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

AS 7

3. (a) Vatika Ltd. has undertaken bridge construction contract wherein, bridge will be constructed in 3 years. The details of the contracts are as follows:
 - (i) Initial contract revenue ₹ 900 crore

(ii) Initial contract cost ₹ 800 crore

	Years		
	I	II	III
	₹ in crore	₹ in crore	₹ in crore
Estimated contract cost	805		
Increase in contract revenue	-	20	
Estimated additional increase cost	-	15	
Contract cost incurred upto	161	584	820

At the end of year II, cost incurred includes ₹ 10 crore, for material stored at the sites to be used in year III to complete the project.

State the amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in these three years.

AS 9

- (b) When will the revenue be recognized in the case of inter divisional transfers?
- (c) New Era Publications publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 20X1 issue was made in February 20X1. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.20X1 and ₹ 60,000 on 10.4.20X1 for the March 20X1 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.20X1. What will be the treatment if the publication is delayed till 2.4.20X1?

AS 11

4. (a) Path Ltd. purchased an item of property, plant and equipment for US \$ 50 lakh on 01.04.20X1 and the same was fully financed by the foreign currency loan [i.e. US \$] repayment in five equal instalments annually. (Exchange rate at the time of purchase was 1 US \$ = ₹ 60). As on 31.03.20X2 the first instalment was paid when 1 US \$ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Path Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss and its treatment and depreciation.

AS 12

- (b) Energy Ltd. has acquired a generator on 1.4.20X1 for ₹ 100 lakh. On 2.4.20X1, it applied to Indian Renewable Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 20X2 after the accounts for 20X1-20X2 were finalized. The company has not accounted for the subsidy for the year ended 31.3.20X2.

State

- (i) Is this a prior period item?
- (ii) How should the subsidy be accounted in the accounting year 20X2-20X3?
- (iii) Would your opinion differ, if the sanction letter for subsidy was received in June 20X2 before the accounts for 20X1-20X2 were approved by the Board of Directors?
- (iv) Would your opinion differ had the company made many similar applications in the past and on all occasions, it has received the subsidy applied for?

AS 13

5. (a) A company is engaged in the business of refining, transportation and marketing of petroleum products. During the financial year ended 31st March, 20X1, the company acquired controlling interest from Government of India in another public sector undertaking @ ₹ 1,551 per share as against the book value of ₹ 192.58 per share and market value of ₹ 876 per share as on 18th February, 20X1.

Thus, the strategic premium of ₹ 675 per share has been paid considering various tangible and intangible factors.

The above investment in the shares of the acquired company has been considered as long term strategic investment and, therefore, has been accounted for at cost, i.e. at ₹ 1,551 per share in the financial statements. No provision for diminution in value has been made in the books of account.

As per the requirement of Schedule III to the Companies Act, 2013, the aggregate market value of the quoted shares has been properly reflected in the financial statements.

On 28th March, 20X1, the acquired shares were quoted at ₹ 880 per share on BSE and the current market price as on 18th July was around ₹ 300.

Considering the tangible and intangible benefits the Management is of the view that there is no permanent diminution in the value of the strategic investment in the acquired company, as the same has been considered as a long-term investment. Therefore, there is no need for provision for diminution in the value of the shares of the acquired company.

Required:

- (i) Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13.
- (ii) If not, what should have been the accounting treatment in such a situation particularly considering the fact that there is no material change in circumstances and strength of the acquired company which further supported the expected benefits from such synergy? Whether the reduction in market value should be considered in isolation for ascertaining the value of such investment or not? What methodology should be adopted for ascertaining the provision for diminution in the value of investment, if any?
- (iii) If any provision for diminution in the value is to be made, whether such provision should be charged to the profit and loss account or whether same can be considered as deferred expenditure and amortised over a period of 5 years. Whether it is open for the company to charge off such diminution in the value in the books of account instead of creating provision.
- (iv) Whether the premium paid for strategic benefits for investment described in facts of the case, can be accounted for separately in the books of account keeping in view that AS 13 specifies that long term investments should be recorded at cost and there is no specific provision in the standard in respect of accounting for premium paid for strategic benefits.

AS 16

- (b) Arohi Ltd. has undertaken a project for expansion of capacity as per the following details:

	Plan (₹)	Actual (₹)
October, 20X1	5,00,000	4,00,000
November, 20X1	6,50,000	7,95,000
December, 20X1	20,00,000	-
January, 20X2	2,00,000	50,000
February, 20X2	9,00,000	2,00,000
March, 20X2	10,00,000	12,00,000

The company pays to its bank interest at a rate of 15% p.a., which is debited on a monthly basis. During the half year, company had ₹ 20 lakh overdraft up to 31st December, surplus cash in January and again overdraft of ₹ 14 lakh from 1.2.20X2 and ₹ 30 lakh from 1.3.20X2. The company had a strike during December and hence could not continue the work during said period. However, the substantial administrative work related to the project was continued. Onsite work was again commenced on 1st January and all the work were completed on 31st March. Assume that expenditure was incurred on 1st day of each month.

Calculate interest to be capitalized giving reason wherever necessary. Assume overdraft will be less, if there is no capital expenditure.

AS 17

6. (a) Whether interest expense relating to overdrafts and other operating liabilities identified to a particular segment should be included in the segment expense or not?

In case interest is included as a part of the cost of inventories where it is so required as per AS 16, read with AS 2 and those inventories are part of segment assets of a particular segment, state whether such interest would be considered as a segment expense.

AS 20

- (b) The following information is available in respect of High-end Ltd. for the accounting year 20X1-20X2 and 20X2-20X3:

Net profit for		₹
Year	20X1-20X2	22,00,000
Year	20X2-20X3	30,00,000

Number of shares outstanding prior to right issue 10,00,000 shares.

Right issue: One new share for each five shares outstanding i.e. 2,00,000 shares.

: Right issue price ₹ 25

: Last date to exercise right 31st July, 20X2.

Fair value of one equity share immediately prior to exercise of rights on 31.07.20X2 is ₹ 32.

You are required to compute, as per AS 20:

- (i) Basic earnings per share for the year 20X1-20X2.
- (ii) Restated basic earnings per share for the year 20X1-20X2 for right issue.
- (iii) Basic earnings per share for the year 20X2-20X3.

AS 23

7. (a) A Ltd. has a share capital of 50,000 shares @ ₹ 100 per share. H Ltd. acquired 15% shares in A Ltd. on 1.4.20X1. It also acquired all the 5,000, 12% convertible debentures of ₹ 100 each of A Ltd. These debentures will be converted at par into equity shares of A Ltd. after 3 years. State whether, as per AS 23, A Ltd. is an Associate of H Ltd. or not with reasons?

AS 24

- (b) Arzoo Ltd. is in the business of manufacture of Passenger cars and commercial

vehicles. The company is working on a strategic plan to shift from the Passenger car segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner.

- (i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.
- (ii) If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS 24?
- (iii) Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner?

AS 28

8. (a) A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit as per AS 28?

AS 29

- (b) A company incorporated under Section 8 of the Companies Act, 2013, have main objective to promote the trade by organizing trade fairs / exhibitions. When company was organizing the trade fair and exhibitions it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair.

The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1. 5% contingency charges are treated as income and matching provision for the same is also being made in accounts.
2. A suitable disclosure to this effect is also made in the notes forming part of accounts.

Required:

- (i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS 29.
- (ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet.

Indian Accounting Standards

9. (a) State the carve out in Ind AS 32 "Financial Instruments: Presentation" from IAS 32 "Financial Instruments: Presentation" alongwith the reason.
- (b) Explain the differences between Ind AS 37 "Provisions, Contingent Liabilities and Contingent Assets" and AS 29 "Provisions, Contingent Liabilities and Contingent Assets".

Corporate Financial Reporting

10. (a) On the basis of available information, show how these items will appear in the Balance Sheet of a Corporate Entity by preparing appropriate notes to accounts which comply with the requirements of the Schedule III to the Companies Act, 2013:

Loan Fund	Schedule No.	As at 31 st March 20X1 (₹)
(a) Secured Loans	1	15,11,220
(b) Unsecured loans - Short term loan from Bank		<u>1,24,190</u>
		16,35,410
Schedule 1: Secured Loans		
Term loans from		
Bank		7,45,120
Others		<u>7,66,100</u>
		<u>15,11,220</u>

Other Information:		
Current maturities of long-term loan from bank		1,15,000
Current maturities of long-term loan from other parties		80,940

Note: There was no interest accrued/due as at the end of the year.

- (b) Arush Ltd. provides following information:

Raw Material stock holding period : 3.5 months

Work-in-progress holding period : 1 month

Finished goods holding period : 4.5 months

Debtors collection period : 6 months

You are required to compute the operating cycle of Arush Ltd. What would happen if the trade payables of the company are paid in 14 months. Whether such trade payables are classified as current or non-current liability?

- (c) The management of Kshitij Ltd. contends that the work in progress is not valued because it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in progress would be more or less the same. Accordingly, the management had not separately disclosed the work in progress in its financial statements. Comment in line with the Schedule III to the Companies Act, 2013.

Accounting for Corporate Restructuring

11. As part of its expansion strategy A Ltd. has decided to amalgamate its business with that of B Ltd. and new company AB Ltd. being incorporated on the 1st December, 20X1 having an authorized equity capital of 2 crore shares of ₹ 10 each. AB Ltd. shall in turn acquire the entire ownership of A Ltd. and B Ltd. in consideration for issuing its equity at 25% premium on 1st January, 20X2. It is also agreed that the consideration shall be based on the product of the profits available to equity shareholders of each entity, times its PE multiple. The preference shareholders & debenture holders are to be satisfied by the issue of similar instruments in AB Ltd. on 1st January, 20X2 in lieu of their existing holdings. Accordingly, the relevant information is supplied to you as under:

	A Ltd.	B Ltd.
Paid up Equity shares of ₹ 10 class (Nos.)	3 Lakh	1.2 Lakh
8% Preference Shares ₹ 10 paid (Nos.)		1 Lakh
5% Redeemable Debentures 20X7-20X8 of ₹ 10 each (Nos.)		0.8 Lakh
Profits before Interest & Taxation (₹)	6,00,000	4,40,000
Price to Earnings Multiple	15	10

To augment the cash retention level of AB Ltd. it is decided that on 1st January, 20X2 AB Ltd. shall collect full share application money from the issue of 20,00,000 equity shares @ 40% premium under Private Placement. The allotment of the shares will be made on 31st March, 20X2 and such shares shall qualify for dividend from 20X2-20X3 only.

AB Ltd. shall also avail a 12.50% TOD of 15 lakh to meet its preliminary expenses and cost of working which amount to ₹ 12 lakh and ₹ 2 lakh respectively. The TOD will be availed on 1st February, 20X2 and closed on 31st March, 20X2. Preliminary expenditure is tax deductible @ 20% each year.

Due to an accounting omission the opening inventory of B Ltd. of 5 lakh (actual value) & the closing stock of A Ltd. of 2.20 lakh was understated & overstated by 5% and 10% respectively.

The dividend schedule proposed is that all companies would pay interim dividend for equity, for the period from 1st January, 20X2 to 31st March, 20X2. The rates of dividend being A Ltd. @ 5%, B Ltd. @ 2% and AB Ltd. @ 3.5%. The preference shareholders & debentureholders dues for the post take over period are discharged on 31st March, 20X2.

It is proposed that in the period January-March 20X2, AB Ltd. would carry out trade in futures that would generate an absolute post tax return of 18% by using the funds generated from the Private Placement. The trades would be squared off on 31st March, 20X2. Proceeds from such transactions are not liable to withholding taxes.

You are required to prepare a projected Profit & Loss A/c for the period ended 31st March, 20X2 and a Balance Sheet on that date for AB Ltd.

The corporate tax rate for the company is 40%.

Consolidated Financial Statements

12. P Ltd. owns 80% of S and 40% of J and 40% of A. J is jointly controlled entity and A is an associate. Summarised Balance Sheets of four companies as on 31.03.20X2 are:

	(₹ in lakh)			
	P Ltd.	S	J	A
Investment in S	800	-	-	-
Investment in J	600	-	-	-
Investment in A	600	-	-	-
Property, Plant and Equipment	1000	800	1400	1000
Current assets	<u>2200</u>	<u>3300</u>	<u>3250</u>	<u>3650</u>
Total	<u>5200</u>	<u>4100</u>	<u>4650</u>	<u>4650</u>

Liabilities:				
Share capital ₹ 1				
Equity share	1000	400	800	800
Retained earnings	4000	3400	3600	3600
Trade payables	<u>200</u>	<u>300</u>	<u>250</u>	<u>250</u>
Total	<u>5200</u>	<u>4100</u>	<u>4650</u>	<u>4650</u>

P Ltd. acquired shares in 'S' many years ago when 'S' retained earnings were ₹ 520 lakh. P Ltd. acquired its shares in 'J' at the beginning of the year when 'J' retained earnings were

₹ 400 lakh. P Ltd. acquired its shares in 'A' on 01.04.20X1 when 'A' retained earnings were ₹ 400 lakh.

The balance of goodwill relating to S had been written off three years ago. The value of goodwill in 'J' remains unchanged.

Prepare the Consolidated Balance Sheet of P Ltd. as on 31.03.20X2 as per AS 21, 23, and 27.

Financial Instruments

13. On 1st April, 20X1, S Ltd. issued 5,000, 8% convertible debentures with a face value of ₹ 100 each maturing on 31st March, 20X7. The debentures are convertible into equity shares of S Ltd. at a conversion price of ₹ 105 per share. Interest is payable annually in cash. At the date of issue, S Ltd. could have issued non-convertible debt with a 5 year term bearing a coupon interest rate of 12%. On 1st April, 20X4 the convertible debentures have a fair value of ₹ 5,25,000. S Ltd. makes a tender offer to debenture holders to repurchase the debentures for ₹ 5,25,000, which the holders accepted. At the date of repurchase, S Ltd. could have issued non-convertible debt with a 2 year term bearing a coupon interest rate of 9%.

Show accounting entries in the books of S Ltd. for recording of equity and liability component:

- At the time of initial recognition and
- At the time of repurchase of the convertible debentures.

The following present values of ₹ 1 at 8%, 9% & 12% are supplied to you:

Interest Rate	Year 1	Year 2	Year 3	Year 4	Year 5
8%	0.926	0.857	0.794	0.735	0.681
9%	0.917	0.842	0.772	0.708	0.650
12%	0.893	0.797	0.712	0.636	0.567

Share Based Payments

14. At the beginning of year 1, an enterprise grants 100 stock options to each of its 500 employees. The grant is conditional upon the employee remaining in service over the next three years. The enterprise estimates that the fair value of each option is ₹ 15. The enterprise estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the stock options.

40 employees left during year 1. By the end of year 1, the share price of the enterprise has dropped, and the enterprise reprices its stock options in the year 2 and that the repriced stock options will vest at the end of year 3. The enterprise estimates that further 70 employees will leave during years 2 and 3.

During year 2, further 35 employees left, and the enterprise estimates that further 30 employees will leave during year 3. During year 3, 28 employees left. The stock options vested at the end of year 3 to the remaining employees.

The enterprise estimates that, at the date of repricing, the fair value of each of the original stock options granted (i.e., before taking into account the repricing) is ₹ 5 and that the fair value of each repriced stock option is ₹ 8.

Calculate the amount to be recognised towards employees services received in years 1-3.

Mutual Fund

15. Calculate the NAV of a Mutual Fund Scheme from the information given below:

At the beginning of the year:

Number of units outstanding 1 Crore units of ₹ 10 each

Investment at cost ₹ 10 crore (Market Value ₹ 16 crore)

Outstanding Liabilities ₹ 5 crore

Other Information:

- (1) Additional 20 lakh units were sold during the year at ₹ 24.
- (2) No additional investments were made during the year and as at the year end, 50% of the investment at year beginning were quoted at 80% of the book value.
- (3) 10% of the investments had witnessed a permanent fall of 10% below cost.
- (4) The balance investments were quoted at ₹ 13.60 crore.
- (5) Outstanding liabilities towards custodian charges, salaries and commission etc. applicable to the scheme were 1 crore.

Non Banking Financial Companies

16. R Limited is a non-banking finance company. It accepts public deposit and also deals in

hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31.3.20X1. Few machines were sold on hire purchase basis. The hire purchase price was set as ₹ 100 lakh as against the cash price of ₹ 80 lakh. The amount was payable as ₹ 20 lakh down payment and balance in 5 equal instalments. The hire vendor collected first instalment as on 31.3.20X2, but could not collect the second instalment which was due on 31.3.20X3. The company was finalising accounts for the year ending 31.3.20X3. Till 15.5.20X3, the date on which the Board of Directors signed the accounts, the second instalment was not collected. Presume IRR to be 10.42%.

Required:

- (i) What should be the principal outstanding on 1.4.20X2? Should the company recognize finance charge for the year 20X2-20X3 as income?
- (ii) What should be the net book value of assets as on 31.3.20X3 so far R Ltd. is concerned as per NBFC prudential norms requirement for provisioning?
- (iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by the RBI?

Valuation of Shares

17. Following is the Balance Sheet of Hoorey Ltd. as on 31st March, 20X6:

Liabilities	₹	Assets	₹
50,000 equity shares of ₹ 10 each	5,00,000	Building	3,50,000
2,500, 12% Preference shares of ₹ 100 each	2,50,000	Plant and Machinery	4,30,000
Profit & Loss A/c	2,20,000	Patents	80,000
15% Debentures	1,20,000	Trade Receivables	2,00,000
General Reserve	1,80,000	Stock in trade	2,90,000
Trade Payables	<u>1,50,000</u>	Cash at Bank	<u>70,000</u>
	<u>14,20,000</u>		<u>14,20,000</u>

Buildings & Plant and Machinery were acquired many years ago and should be considered as worth of ₹ 5,00,000 and ₹ 6,30,000 respectively.

The Profits for the last five years were as follows:

Year	Profit (before tax) ₹
20X1-20X2	1,80,000
20X2-20X3	2,50,000
20X3-20X4	60,000

20X4-20X5	3,00,000
20X5-20X6	3,50,000

The company paid a remuneration of ₹ 50,000 p.a. to the managerial personnel, but in future it will be paying ₹ 75,000, the increase having been sanctioned by the Government. During 20X3-20X4, there was a prolonged strike, resulting in low profits. There has been no substantial change in the capital employed. The company has paid a dividend of 12 percent on equity shares consistently and proposes to stick to this rate in the foreseeable future. In the class of business to which the company belongs, the dividend rates have been fluctuating and the asset backing of an equity share is about 2 times. Equity shares with an average dividend of 15% sell at par. The company is anxious to provide funds for replacement of assets when due, for which it is proposed to make 20% provision on PAT. Assume future tax rate to be 40%. Calculate the value of an equity share of Hoorey Ltd. on yield basis.

Value Added Statement

18. Hindusthan Corporation Limited (HCL) has been consistently preparing Value Added Statement (VAS) as part of Financial Reporting. The Human Resource department of the Company has come up with a new scheme to link employee incentive with 'Value Added' as per VAS. As per the scheme an Annual Index of Employee cost to Value Added annually (% of employee cost to Value Added rounded off to nearest whole number) shall be prepared for the last 5 years and the best index out of results of the last 5 years shall be selected as the 'Target Index'. The Target Index percentage shall be applied to the figure of 'Value Added' for a given year to ascertain the target employee cost. Any saving in the actual employee cost for the given year compared to the target employee cost will be rewarded as 'Variable incentive' to the extent of 70% of the savings. From the given data, you are requested to ascertain the eligibility of 'Variable Incentive' for the year 20X6-20X7 for the employees of the HCL.

Value added statement of HCL for last 5 years (₹ in lakh)

Year	20X1-X2	20X2-X3	20X3-X4	20X4-X5	20X5-X6
Sales	3,200	3,250	2,900	3,800	4,900
Less: Bought out goods and services	<u>2,100</u>	<u>2,080</u>	<u>1,940</u>	<u>2,510</u>	<u>3,200</u>
Value added	<u>1,100</u>	<u>1,170</u>	<u>960</u>	<u>1,290</u>	<u>1,700</u>

Application of Value Added

Year	20X1-X2	20X2-X3	20X3-X4	20X4-X5	20X5-X6
To Pay Employees	520	480	450	600	750
To Providers of Capital	160	170	120	190	210

To Government Tax	210	190	220	300	250
For Maintenance and expansion	210	330	170	200	490

Summarized Profit and Loss Account of the HCL for 20X6-20X7 (₹ in lakh)

Sales		5,970
Less: Material consumed	1,950	
Wages	400	
Production salaries	130	
Production expenses	500	
Production depreciation	150	
Administrative salaries	150	
Administrative expenses	200	
Administrative depreciation	100	
Interest	150	
Selling and distribution salaries	120	
Selling expenses	350	
Selling depreciation	<u>120</u>	<u>4,320</u>
Profit		<u>1,650</u>

Economic Value Added

19. Life Industries Ltd (LIL) furnishes the following information from which you are required to calculate the prevailing Economic Value Added of the company and also explain the reason for the difference, if any, between the EVA as calculated by you and the MVA (Market Value Added) of LIL amounting to ₹ 14005 crore.

Common shares of ₹ 1,000 face value	1,58,200 units
12% Debentures ₹ 10 face value	50,00,000 units
Current tax rate	30%
Financial Leverage	1.1 times
Securities Premium Account (Rupees in lakh)	155
Free Reserves (Rupees in lakh)	154
Capital Reserve (Rupees in lakh)	109

It is a prevailing practice for companies in the industry to which LIL belongs to pay at least a dividend of 15% p.a. to its common shareholders.

Human Resource Accounting

20. A company has a capital base of ₹ 1 crore and has earned profits to the tune of ₹ 11 lakh. The Return on Investment (ROI) of the particular industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by ₹ 2.5 lakh over and above the target profit.

Determine the amount of maximum bid price for that particular executive and the maximum salary that could be offered to him.

ANSWERS

1. (a) As per para 9 of AS 2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production overheads is based on the normal capacity of the production facilities.

In this, case finished stock has been valued at a standard cost of ₹ 1.8 lakh per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

		(₹ in lakh)
Materials		400
Direct Labour		250
Variable production overheads		150
Fixed production overheads	290	
Less: Interest	<u>(100)</u>	<u>190</u>
Total cost		<u>990</u>

Number of computers produced = 550 computers (Assumed to be normal production)

Cost per computer ₹ 990 lakh / 550 computers = ₹ 1.80 lakh

Policy of the company to value closing stock on the basis of standard costing is not as per AS 2. As per para 18 of AS 2, the techniques of standard cost method may be used for convenience if the result approximates to the actual cost. However, standard cost should be regularly reviewed, if necessary, and be revised in the light of the current conditions. In the instant case, the cost of inventory can be conveniently calculated as per absorption costing. Therefore, there is no reason to adopt standard costing method.

- (b) **Treatment as per AS 3 'Cash Flow Statement'**

- (i) Loans and advances given and interest earned

- (1) to suppliers Cash flows from operating activities
- (2) to employees Cash flows from operating activities
- (3) to its subsidiary companies Cash flows from investing activities
- (ii) Investment made in subsidiary company and dividend received
Cash flows from investing activities
- (iii) Dividend paid for the year
Cash flows from financing activities
- (iv) TDS on interest income earned on investments made
Cash flows from investing activities
- (v) TDS on interest earned on advance given to suppliers
Cash flows from operating activities
- (vi) Insurance claim received against loss of property, plant and equipment by fire.
Extraordinary item to be shown under a separate heading as 'Cash inflow from operating activities'.

2. (a) Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(a)	A Ltd.	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended on 31.3.20X1 and the profit on sale of property ₹ 1,50,000 would be treated as an extraordinary item.
(b)	B Ltd.	The declaration of dividend on 30 th April, 20X1 of ₹ 3,00,000 would be treated as a non-adjusting event in the financial statements of 20X0-20X1. This is because, the dividend has been declared after the balance sheet date and no conditions existed on the balance sheet date for such declaration of dividend. Further as per AS 9, right to receive dividend is established when it is declared and not before that.
(c)	C Ltd.	A closure not anticipated at the year-end would be treated as a non-adjusting event. Memorandum disclosure would be required for closure of mail order activities since non disclosure would affect user's understanding of the financial statements.
(d)	D Ltd.	The event took place after the financial statements were approved by the approving authority and is thus outside the purview of AS 4. However, in view of its significance of the transaction, the directors may consider publishing a separate

		financial statement/additional statement for the attention of the members in general meeting.
(e)	E Ltd.	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.
(f)	F Ltd.	On the basis of evidence provided, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts as per AS 9. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.
(g)	G Ltd.	The change in exchange rates is a non adjusting event since it does not relate to the conditions existing at the balance sheet date. However, they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

(b) As per para 31 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

- (i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.
- (ii) Similarly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

3. (a) Statement showing analysis of the contract details

		(₹ in crore)		
		Year I	Year II	Year III
(a)	Initial revenue agreed	900	900	900
(b)	Increase in contract revenue	-	20	20
(c)	Total Contract Value	900	920	920

(d)	Contract cost incurred upto the date of reporting	161	574 (excluding ₹ 10 crore of material stored)	820
(e)	Estimated cost to complete	644	246	-
(f)	Total estimated contract	805	820	820
(g)	Stage of Completion [(d/f) x 100]	20% (161/805x100)	70% (574/820x100)	100% (820/820x100)

Statement showing amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in three years (₹ in crore)

	<i>Upto reporting date</i>	<i>Recognised in the prior year</i>	<i>Recognized in the current year</i>
Year I			
Revenue (900 x 20/100)	180	-	180
Expenses	<u>161</u>	<u>-</u>	<u>161</u>
Profit	<u>19</u>	<u>-</u>	<u>19</u>
Year II			
Revenue (920 x 70/100)	644	180	464
Expenses (820 x 70/100)	<u>574</u>	<u>161</u>	<u>413</u>
Profit	<u>70</u>	<u>19</u>	<u>51</u>
Year III			
Revenue	920	644	276
Expenses	<u>820</u>	<u>574</u>	<u>246</u>
Profit	<u>100</u>	<u>70</u>	<u>30</u>

- (b) The Accounting Standard Board of ICAI has come up with an announcement in the earlier years wherein it clarified that the inter-divisional transfers / sales are not revenue as per AS 9 "Revenue Recognition". According to it, in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Therefore, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. Hence, no revenue is recognized in the case of inter-divisional transfers.

- (c) As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.20X1 is the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 20X1. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of ₹ 3,00,000 will be recognised in the March, 20X1, ₹ 60,000 will be treated as amount due from advertisers as on 31.03.20X1 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.20X1 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized in the year ended 31.03.20X2 after the magazine is published on 02.04.20X1. The amount received from sale of advertising space on 10.03.20X1 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.20X1.

4. (a) Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Path Ltd. has exercised the option and it is long term foreign currency monetary item.

Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.20X2 on payment of US \$ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh \$ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.20X2 = ₹ 40 lakh US \$ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh.

Total depreciation to be provided for the year 20X1 - 20X2 = 20% of (₹ 3,000 lakh + 100 lakh) = ₹ 620 lakh.

- (b) (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 20X1-20X2 by not recognising the subsidy?

The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that

- (i) the enterprise will comply with the conditions attached to them and
- (ii) the subsidy will be received.

Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 20X2 after approval of accounts, non-recognition of grant in 20X1-20X2 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 20X1-20X2.

- (ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as 'deferred income' and allocated over the remaining useful life in the proportion in which depreciation is charged.

- (iii) Here in this case, the opinion given in (i) and (ii) above would change. AS 4 requires the value of assets and liabilities to be adjusted for events occurring after the balance sheet date which occur upto the date of approval of accounts by the Board of Directors if they confirm the conditions existing at the balance sheet date. Since, in this case books of account have not been approved, grant of subsidy will be considered as an adjusting event. Hence, the accounts should be adjusted for the subsidy in 20X1-20X2. The subsidy should be credited to the cost of the generator.

Alternatively, the subsidy may be treated as deferred income to be written off over the useful life in proportion in which depreciation is written off.

- (iv) As per the past experience of the company wherein similar applications were made and subsidy was granted on all occasion, one can conclude that the reasonable assurance that subsidy will be received, as envisaged in Para 13, is there in the form of past records. If there are no changes in the subsidy scheme and the application is submitted in the same manner as in the past, then subsidy should have been accounted in 20X1-20X2 itself. The opinion in

(i) and (ii) would change. The opinion in (iii) above will hold good in this case also.

5. (a) (i) The accounting treatment 'at cost' under the head 'Long Term Investment' in the separate financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment.
- (ii) If the decline in the value of investment is not other than temporary compared to the time when the shares were purchased, no provision is required to be made. The reduction in market value should not be considered in isolation to determine the decline, other than temporary. The amount of the provision for diminution in the value of investment may be ascertained considering the factors indicated in paragraph 17 of AS 13.
- (iii) The provision for diminution in the value of investment should be a charge to the profit and loss statement. As per the requirements of AS 13, the diminution in the value of investment can neither be accounted for as deferred revenue expenditure nor it can be written off in the statement of profit and loss.
- (iv) The long-term investments should be carried at cost as per the requirements of AS 13. The amount paid over and above the market price should be treated as cost and cannot be accounted for separately.

(b) **Arohi Ltd.**

<i>Month</i>	<i>Actual Expenditure (₹)</i>	<i>Interest capitalized (₹)</i>	<i>Cumulative amount (₹)</i>
October, 20X1	4,00,000	5,000	4,05,000
November, 20X1	7,95,000	15,000	12,15,000
December, 20X1	-	15,188	12,30,188
January, 20X2	50,000	-	12,80,188
February, 20X2	2,00,000	17,500	14,97,688
March, 20X2	<u>12,00,000</u>	<u>33,721</u>	27,31,409
	<u>26,45,000</u>	<u>86,409</u>	

Note:

- As per para 18 of AS 16, 'Borrowing Cost', capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Therefore, the interest for that period i.e. for the month of December has also been capitalized.
- During January, the company did not incur any interest as there was surplus cash in January. Therefore, no amount should be capitalized during January as per para 14(b) of AS 16.

3. During February, actual overdraft (borrowings) was ₹ 14 lakh only. Hence, interest of ₹ 17,500 on ₹ 14,00,000 has been calculated even though actual expenditure on project exceed ₹ 14 lakh.
6. (a) The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

In case interest is included as part of the cost of inventories where it is so required as per AS 16 "Borrowing Costs", read with AS 2 "Valuation of Inventories", and those inventories are part of segment assets of a particular segment, such interest should be considered as a segment expense.

In this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest should be disclosed by way of a note to the segment result.

(b) **Computation of basic earnings per share**

	20X1-20X2 (₹)	20X2-20X3 (₹)
EPS for the year 20X1-20X2 as originally reported = Net profit for the year attributable to equity shareholders / weighted average number of equity shares outstanding during the year = ₹ 22,00,000 / 10,00,000 shares	2.20	
EPS for the year 20X1-20X2 restated for the right issue = ₹ 22,00,000 / (10,00,000 x 1.04)	2.12	
EPS for the year 20X2-20X3 (including effect of right issue) = ₹ 30,00,000 / {(10,00,000 x 1.04 x 4/12) + (12,00,000 x 8/12)}		2.62

Working Notes:

- Computation of theoretical ex-rights fair value per share = (fair value of all outstanding shares immediately prior to exercise of rights + Total value received from exercise of rights) / (number of shares outstanding prior to exercise + number of shares issued on the exercise)
= (₹ 32 x 10,00,000 + ₹ 25 x 2,00,000) / (10,00,000 + 2,00,000) = ₹ 30.83
- Computation of adjustment factor
= Fair value per share prior to exercise of rights / Theoretical ex-right value per share

$$= ₹ 32/₹ 30.83$$

$$= 1.04 \text{ (approx.)}$$

7. (a) As per para 3 of AS 23 'Accounting for Investments in Associates in Consolidated Financial Statements', an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Standard further explains in para 4 that as regards share ownership, if an investor holds, directly or indirectly through subsidiary (ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary (ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

Further as per an explanation to para 4 of the standard, for the purpose of classification of associate, the potential equity shares of the investee held by the investor will not be taken into account for determining the voting power of the investor. In other words, the voting power should be determined on the basis of the current outstanding securities with voting rights.

As per the information given in the question, H Ltd. presently holds indirectly 22.7% shares (with and without voting rights) (Refer W.N.) in A Ltd. However, the current outstanding securities with voting rights in A Ltd. is only 15% and the remaining holding is on account of potential equity shares. Since potential equity shares do not have voting rights they will not be taken into consideration while determining the significant influence of H Ltd. on A Ltd. Hence, A Ltd. is not an associate of H Ltd.

Working Note:

Calculation of percentage of holding of shares after conversion

	₹
Current holding is 15% i.e. 7,500 shares of ₹ 100 each	7,50,000
Potential equity shares i.e. 5,000 shares of ₹ 100 each	<u>5,00,000</u>
	<u>12,50,000</u>

Total share capital of A Ltd. after conversion of debentures into equity shares will be = ₹ 50,00,000 + ₹ 5,00,000 = ₹ 55,00,000

Percentage of holding = ₹ (12,50,000/55,00,000) x 100 = 22.7% approx.

- (b) Mere gradual phasing out is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

- (1) Gradual or evolutionary phasing out of a product line or class of service;
- (2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- (3) Shifting of some production or marketing activities for a particular line of business from one location to another; and
- (4) Closing of a facility to achieve productivity improvements or other cost savings.

A Reportable business segment or geographical segment as defined in AS 17, would normally satisfy criteria (b) of the definition.

In view of the above the answers are:

- (i) No, the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Above all, the new segment i.e. commercial vehicle production line in a new factory has not started.
 - (ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, closure road map and new segment starting roadmap are missing. Hence, AS 24 will not be applicable.
 - (iii) Yes, phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap. Hence, this action will attract compliance of AS 24.
8. (a) It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

- (b) (i) Para 14 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets" states that a provision should be recognised when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the

obligation. If these conditions are not met, no provision should be recognised.

From the above, it is clear that in the contingencies considered by the company, neither a present obligation exists as a result of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognised for such contingencies under the facts and circumstances of the case.

- (ii) "Provision" is the amount retained by the way of providing for any known liability. Since the contingencies stipulated by the company are not known at the balance sheet date, the provision in this regard cannot be created. Therefore, the provision so created by the company shall be treated as a 'Reserve'.

9. (a) Carve Out in Ind AS 32 vis-à-vis IAS 32

As per IFRS: As per accounting treatment prescribed under IAS 32, equity conversion option in case of foreign currency denominated convertible bonds is considered a derivative liability which is embedded in the bond. Gains or losses arising on account of change in fair value of the derivative need to be recognised in the Statement of Profit and Loss as per IAS 32.

Carve out: In Ind AS 32, an exception has been included to the definition of 'financial liability' in paragraph 11 (b) (ii), whereby conversion option in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments is classified as an equity instrument if the exercise price is fixed in any currency.

Reasons: This treatment as per IAS 32 is not appropriate in instruments, such as, Foreign Currency Convertible Bonds (FCCBs) since the number of shares convertible on the exercise of the option remains fixed and the amount at which the option is to be exercised in terms of foreign currency is also fixed; merely the difference in the currency should not affect the nature of derivative, i.e., the option. Further, the fair value of the option is based on the fair value of the share prices of the company. If there is decrease in the share price, the fair value of derivative liability would also decrease which would result in recognition of gain in the statement of profit and loss. This would bring unintended volatility in the statement of profit and loss due to volatility in share prices. This will also not give a true and fair view of the liability as in this situation, when the share prices fall, the option will not be exercised. However, it has been considered that if such option is classified as equity, fair value changes would not be required to be recognised. Accordingly, the exception has been made in definition of financial liability in Ind AS 32.

- (b) Significant differences between Ind AS 37 vis a vis AS 29:
- (i) **Constructive obligations and Change in the Definition of Provision and Obligating Event:** Unlike AS 29, Ind AS 37 requires creation of provisions in respect of constructive obligations also. [However, AS 29 requires creation of provisions arising out of normal business practices, custom and a desire to maintain good business relations or to act in an equitable manner]. This has resulted in some consequential changes also. For example, definitions of provision and obligating event have been revised in Ind AS 37, while the terms 'legal obligation' and 'constructive obligation' have been inserted and defined in Ind AS 37. Similarly, the portion of AS 29 pertaining to restructuring provisions has been revised in Ind AS 37.
 - (ii) **Discounting Provisions:** AS 29 prohibits discounting the amounts of provisions except in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment. Ind AS 37 requires discounting the amounts of provisions, if effect of the time value of money is material.
 - (iii) **Disclosure of Contingent Assets:** AS 29 notes the practice of disclosure of contingent assets in the report of the approving authority but prohibits disclosure of the same in the financial statements. Ind AS 37 requires disclosure of contingent assets in the financial statements when the inflow of economic benefits is probable. The disclosure, however, should avoid misleading indications of the likelihood of income arising.
 - (iv) **Onerous Contracts:** Ind AS 37 makes it clear that before a separate provision for an onerous contract is established, an entity should recognise any impairment loss that has occurred on assets dedicated to that contract in accordance with Ind AS 36. There is no such specific provision in AS 29.
 - (v) **Future Operating Losses:** AS 29 states that identifiable future operating losses up to the date of restructuring are not included in a provision. Ind AS 37 gives an exception to this principle viz. such losses related to an onerous contract.
 - (vi) **Appendix:** Ind AS 37 gives guidance on:
 - (a) Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
 - (b) Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment
 - (c) Levies (imposed by government).AS 29 does not give such guidance.

10. (a) Balance Sheet of a Corporate Entity (An Extract) as on 31st March, 20X1

Particulars	Note No.	Amount
Non-Current Liabilities		
Long term borrowings	1	13,15,280
Current liabilities		
Short term borrowing	2	1,24,190
Other current liabilities	3	<u>1,95,940</u>
		<u>16,35,410</u>

Notes to Accounts

1.	Long term Borrowing	₹
	Term loans – secured	
	- from bank	7,45,120
	- from other parties	<u>7,66,100</u>
		15,11,220
	Less: Shown in current maturities of long-term loans	<u>(1,95,940)</u>
		<u>13,15,280</u>
2.	Short-term borrowings (Unsecured-payable on demand)	1,24,190
	- from bank	
3.	Other current liabilities	
	Current maturities of long-term loans	
	From bank	1,15,000
	From others	<u>80,940</u>
		<u>1,95,940</u>

- (b) According to Schedule III to the Companies Act, 2013 “An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents”.

Accordingly, operating cycle of Arush Ltd. will be computed as:

Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period

$$= 3.5 \text{ months} + 1 \text{ month} + 4.5 \text{ months} + 6 \text{ months} = 15 \text{ months}$$

Further, a liability shall be classified as current when it is expected to be settled in the Company's normal operating cycle.

Since the operating cycle of Arush Ltd. is 15 months, trade payables expected to be paid in 14 months should be treated as a current liability.

- (c) Schedule III to the Companies Act, 2013 does not require work-in-progress to be disclosed in the Statement of Profit and Loss. Thus, amounts for which work-in-progress have been completed at the beginning and at the end of the accounting period may not be disclosed. Therefore, the non-disclosure in the financial statements by the company may not amount to violation of the Schedule III to the Companies Act, 2013 if the differences between opening and closing WIP are not material.

11. Projected Profit & Loss Account of AB Ltd. for the period ended 31st March, 20X2

Particulars	₹	Particulars	₹
To Working capital expenses	2,00,000	By Profits from Futures Trading	84,00,000
To Interest on TOD	31,250	By Dividends received	1,74,000
To Debenture interest	10,000		
To Provision for tax @ 40% on pre-tax profit - ₹ 81,58,750	32,63,500		
To Profit after tax	<u>50,69,250</u>		
	<u>85,74,000</u>		<u>85,74,000</u>
To Dividends (Equity & Preference)	2,06,760	By Profit for the year after tax	50,69,250
To Profit transferred to Balance Sheet	<u>48,62,490</u>		
	<u>50,69,250</u>		<u>50,69,250</u>

Projected Balance Sheet of AB Ltd. as at 31-3-20X2

Liabilities	₹	Assets	₹
Authorised share capital		Investments in Subsidiaries	
2 crore Equity shares of ₹ 10 each	<u>20,00,00,000</u>	In Equity shares at cost	66,70,000
Issued, subscribed & paid up 25,33,600 Shares of ₹ 10 each (of the above 5,33,600 shares issued for consideration other than cash)	2,53,36,000	In preference shares at cost	10,00,000
		5% Red. Deb 20X7-20X8 of ₹ 10	8,00,000

Preference Shares		Current Assets, Loans & Advances	
1 lakh 8% Preference Shares ₹ 10 paid	10,00,000		
Reserves & Surplus		Bank Balance	3,49,25,990
Securities Premium Account (93,34,000 – 12,00,000)	81,34,000		
Profit & Loss Account	48,62,490		
Secured loan			
5% Red. Debentures 20X7-20X8 of ₹ 10 each	8,00,000		
Current Liabilities & Provisions			
Provision for taxation	<u>32,63,500</u>		
	<u>4,33,95,990</u>		<u>4,33,95,990</u>

Note:

- Dividend received is exempted income and is not subject to tax in the hands of recipient. It is assumed that rate of dividend given in the question is net of tax.
- Dividend distributed by AB Ltd. is subject to dividend distribution tax, if not net of tax.
- As per the Companies Act, 2013, the balance of securities premium account can be used for writing off the preliminary expenses. As the company is having sufficient balance in the securities premium account, the amount of preliminary expenses is adjusted from the balance of securities premium account. As per para 56 of AS 26, when an expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognized, then such an expenditure is recognized as an expense when it is incurred. However, whenever there is conflict in the treatment of a particular item as per Law / Statue & Accounting Standards then the Law / Statue will prevail. Accordingly, the above question has been solved by setting off the preliminary expenses from Securities Premium A/c. In this case it will be treated as permanent difference. Hence no DTA/DTL will be created.

Working Notes:**1. Calculation of Rectified Profits**

	A Ltd. (₹)	B Ltd. (₹)
Value of inventory as given	2,20,000 (Overstated)	5,00,000 (Actual)

Adjustment therein due to incorrect valuation will be reduced from profits	$2,20,000 \times 10/110$ = 20,000	$5,00,000 \times 5/100$ = 25,000
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2. Computation of Shares to be issued as purchase consideration

	A Ltd. ₹	B Ltd. ₹
Profit before interest & tax	6,00,000	4,40,000
Less: Reduction in profit due to incorrect inventory valuation	(20,000)	(25,000)
Less: Debenture interest	—	(40,000)
Profit before tax	5,80,000	3,75,000
Less: Tax @ 40%	(2,32,000)	(1,50,000)
Profit after tax (PAT)	3,48,000	2,25,000
Less: Preference dividend	—	(80,000)
Profit available to equity shareholders [A]	<u>3,48,000</u>	<u>1,45,000</u>
Price Earnings Multiple [B]	15	10
Total Purchase Consideration to be given (A x B)	<u>52,20,000</u>	<u>14,50,000</u>
Equity Share Capital (Purchase Consideration x 100/125)	41,76,000	11,60,000
Securities Premium (25% of the above)	10,44,000	2,90,000

3. Bank Account

Date	Particulars	₹	Date	Particulars	₹
1.1.20X2	To Share Application Money (20,00,000 x ₹ 14)	2,80,00,000	1.1.20X2	By Futures Trading A/c	2,80,00,000
1.2.20X2	To 12.5% TOD	15,00,000	1.2.20X2	By Preliminary Expenses	12,00,000
31.3.20X2	To Future Trading A/c [(2,80,00,000 x (18/100) x (100/60) + 2,80,00,000)	3,64,00,000	31.3.20X2	By Working Capital expenses	2,00,000
31.3.20X2	To Dividend received		31.3.20X2	By Dividends Paid [(41,76,000 + 11,60,000) x 3.5/100]	1,86,760

A Ltd (3,00,000 x 10 x 5%)	1,50,000		31.3.20X2	By TOD Interest (15,00,000 x 12.5/100 x 2/12)	31,250
B Ltd. (1,20,000 x 10 x 2 %)	<u>24,000</u>	1,74,000	31.3.20X2	By Debenture Interest (80,000 x ₹ 10 x 5/100 x 3/12)	10,000
			31.3.20X2	By Preference Dividend (1,00,000 x ₹ 10 x 8/100 x 3/12)	20,000
			31.3.20X2	By 12.5% TOD	15,00,000
			31.3.20X2	By Balance c/d	<u>3,49,25,990</u>
		<u>6,60,74,000</u>			<u>6,60,74,000</u>

12. Consolidated Balance Sheet of P Ltd. as on 31.3.20X2

Particulars	Note No.	(₹ in lacs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		1,000
(b) Reserves and Surplus	1	8,800
(2) Minority Interest (W.N.3)		760
(3) Current Liabilities		
Trade Payables (200+ 300 + 40% of 250)		600
Total		<u>11,160</u>
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment [1,000 + 800 + 560 (1400 x 40%)]		2,360
(b) Intangible assets (W.N.1)		120
(c) Investment	2	1,880
(2) Current assets [2,200+3,300+1,300 (3,250x40%)]		6,800
Total		<u>11,160</u>

Notes to Accounts

		₹ in lacs
1.	Reserves and Surplus	
	Retained Earnings (W.N.2)	8,800
2.	Non-current investment	
	Investment in Associates (W.N.4)	1,880

Working Notes:**1. Computation of Goodwill****S (subsidiary)**

		₹ in lacs
Cost of investment		800
Less: Paid up value of shares acquired	320	
Share in pre- acquisition profits of S Ltd. (520 × 80%)	<u>416</u>	<u>(736)</u>
Goodwill		<u>64</u>

J (Jointly Controlled Entity)

		₹ in lacs
Cost of Investment		600
Less: Paid up value of shares acquired (40% of 800)	320	
Share in pre-acquisition profits (40% of 400)	<u>160</u>	<u>(480)</u>
Goodwill		<u>120</u>

Note: Jointly controlled entity 'J' to be consolidated on proportionate basis i.e. 40% as per AS 27

Associate A (AS 23)

		₹ in lacs
Cost of investment		600
Less: Paid up value of shares acquired (800 × 40%)	₹ 320	
Share in pre-acquisition profits (400 × 40%)	<u>₹ 160</u>	<u>(480)</u>
Goodwill		<u>120</u>

Goodwill shown in the Consolidated Balance Sheet

	₹ in lacs
Goodwill of 'J'	120
Goodwill of 'S'	64
Less: Goodwill written off of 'S'	<u>(64)</u>
Goodwill	<u>120</u>

2. Consolidated Retained Earnings

	₹ in lacs
P Ltd.	4,000
Share in post acquisition profits of S - 80% (3,400 – 520)	2,304
Share in post acquisition profits of J - 40% (3,600 – 400)	1,280
Share in post acquisition profits of A - 40% (3,600 – 400)	1,280
Less: Goodwill written off	<u>(64)</u>
	<u>8,800</u>

3. Minority Interest 'S'

	₹ in lacs
Share Capital (20% of 400)	80
Share in Retained Earnings (20% of 3,400)	<u>680</u>
	<u>760</u>

4. Investment in Associates

	₹ in lakh
Cost of Investments (including goodwill ₹ 120 lakh)	600
Share of post acquisition profits	<u>1,280</u>
Carrying amount of Investment (including goodwill ₹ 120 lakh)	<u>1,880</u>

13. (i) At the time of initial recognition

	₹
Liability component	
Present value of 5 yearly interest payments of ₹ 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of ₹ 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	<u>4,27,700</u>

Equity component (₹ 5,00,000 – ₹ 4,27,700)	72,300
Total proceeds	5,00,000

Note: Since ₹ 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ ₹ 100 each only.

Journal Entry

	₹	₹
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 8% Debentures (Equity component)		72,300
(Being Debentures are initially recorded a fair value)		

(ii) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference
	₹	₹	₹
Liability component			
Present value of 2 remaining yearly interest payments of ₹ 40,000, discounted at 12% and 9%, respectively	67,600	70,360	
Present value of ₹ 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	<u>3,98,500</u>	<u>4,21,000</u>	
Liability component	4,66,100	4,91,360	(25,260)
Equity component (5,25,000 -4,91,360)	<u>72,300</u>	<u>33,640*</u>	<u>38,660</u>
Total	<u>5,38,400</u>	<u>5,25,000</u>	<u>13,400</u>

*(5,25,000 – 4,91,360) = 33,640

Journal Entries

		₹	₹
8% Debentures (Liability component) Dr.		4,66,100	
Profit and loss A/c (Debt settlement expense) Dr.		25,260	
To Bank A/c			4,91,360
<i>(Being the repurchase of the liability component recognised)</i>			
8% Debentures (Equity component) Dr.		72,300	
To Bank A/c			33,640
To Reserves and Surplus A/c			38,660
<i>(Being the cash paid for the equity component recognised)</i>			

14. The incremental value is ₹ 3 per stock option (₹ 8 – ₹ 5). This amount is recognised over the remaining two years of the vesting period, along with remuneration expense based on the original option value of ₹ 15.

The amount of expenses recognised towards employees services received in years 1- 3 are as follows:

Year	Calculation	Compensation expense for period (₹)	Cumulative compensation expense (₹)
1	(500 – 110) employees × 100 options × ₹ 15 × 1/3	1,95,000	1,95,000
2	(500 – 105) employees × 100 options × (₹ 15 × 2/3 + ₹ 3 × 1/2) – ₹ 1,95,000	2,59,250	4,54,250
3	(500 – 103) employees × 100 options × (₹ 15 + ₹ 3) – ₹ 4,54,250	2,60,350	7,14,600

15. Calculation of NAV of a Mutual Fund Scheme

Units as at the end of the year		Units in Crore
Number of units at the beginning of the year		1.00
Add: Units issued during the year		<u>0.20</u>
Units as at end of the year		<u>1.20</u>
Net Asset Value of the scheme		₹ in crore
Market value of Investments	(50% of ₹ 10 crore) × 80%	4.00

	10% x ₹ 10 crore - (10% below cost)	0.90
	Balance Investment at Market Price	<u>13.60</u>
Total Market Value		18.50
Less: Mutual fund scheme liabilities		<u>(1.00)</u>
Net asset value of the scheme		<u>17.50</u>
NAV per Unit= B/A=	₹ 17.50 crore/1.2 crore	₹ 14.58

16. (i) Since, the hire-purchaser paid the first instalment due on 31.3.20X2, the notional principal outstanding on 1-4-20X2 was ₹ 50.25 lakh (refer W.N.).

For the year ended 31.03.20X3, the instalment due of ₹ 16 lakh has not been received. However, it was due on 31.3.20X3 i.e. on the balance sheet date, and therefore, it will be classified as standard asset. R Ltd. will recognise ₹ 5.24 lakh as interest income included in that due instalment and it should be treated as finance charge.

(ii) **The net book value of the assets as on 31.3.20X3**

	₹ in lakh
Overdue instalment	16.00
Instalments not due (₹ 16 lakh x 3)	<u>48.00</u>
	64.00
Less: Finance charge not matured and hence not credited to Profit and loss account (4.11 + 2.88 + 1.52) (W.N.)	<u>(8.51)</u>
	55.49
Less: Provision as per para 9(2)(i) of NBFC prudential norms (Refer point (iii))	<u>(7.49)</u>
Net book value of assets for R Ltd.	<u>48.00</u>

(iii) **Amount of Provision**

	₹ in lakh
Overdue instalment	16.00
Instalments not due (₹ 16 lakh x 3)	<u>48.00</u>
	64.00
Less: Finance charge not matured and hence not credited to Profit and loss account (4.11 + 2.88 + 1.52) (W.N.)	<u>(8.51)</u>
	55.49

Less: Depreciated value (cash price less depreciation for two years on SLM @ 20%*)	(48.00)
Provision to be created as per para 9(2)(i) of NBFC prudential norms	<u>7.49</u>

Since, the instalment of ₹ 16 lakh not paid, was due on 31.3.20X3 only, the asset is classified as standard asset. Therefore, no additional provision has been made for it.

Working Note:

It is necessary to segregate the instalments into principal outstanding and interest components by using I.R.R. @ 10.42%.

(₹ in lakh)

Time	Opening outstanding amount (a)	Cash flow (b)	Interest @ 10.42% (c) = (a x 10.42%)	Principal repayment (d) = (b – c)	Closing outstanding (e) = (a – d)
31-3-20X1		(60)	-----	---	60.00
31-3-20X2	60.00	16	6.25	9.75	50.25
31-3-20X3	50.25	16	5.24	10.76	39.49
31-3-20X4	39.49	16	4.11	11.89	27.60
31-3-20X5	27.60	16	2.88	13.12	14.48
31-3-20X6	14.48	16	1.52	14.48	0.00

17. Calculation of value per share on yield basis (Earnings Capitalisation Method)

Particulars	
Earnings available to equity shareholders (W.N.1)	₹ 1,01,040
Normal Rate of Return (W.N.3)	14.25%
Value of business	₹ 7,09,053
Number of equity shares outstanding	50,000
Value per share	14.18

* As per NBFC prudential norms laid down by the RBI.

Working Notes:**1. Computation of FMP available for distribution****a. Weighted average profits**

Year	Profit before tax	Weight	Product
20X1-20X2	1,80,000	1	1,80,000
20X2-20X3	2,50,000	2	5,00,000
20X4-20X5	3,00,000	3	9,00,000
20X5-20X6	3,50,000	<u>4</u>	<u>14,00,000</u>
		<u>10</u>	<u>29,80,000</u>

Note: Profit of the year 20X3-20X4 has not been considered, because it is a year of strike (Abnormal operation).

	₹
<u>29,80,000</u>	2,98,000
Weighted average profit = $\frac{29,80,000}{10}$	
Less: Increase in managerial remuneration	<u>(25,000)</u>
PBT	2,73,000
Tax @ 40%	<u>(1,09,200)</u>
PAT	1,63,800
Less: Provision for replacement of Property, plant and Equipment (₹ 1,63,800 x 20%)	<u>(32,760)</u>
	1,31,040
Less: Dividend for preference shares (₹ 2,50,000 x 12%)	<u>(30,000)</u>
Earnings available for distribution	<u>1,01,040</u>

2. Ascertainment of NRR criteria as applicable to Hoorey Ltd.**(A) Asset backing:**

Particulars		₹
Total assets as per balance sheet		14,20,000
Add: Increase in the value of building	1,50,000	
Increase in the value of plant & machinery	<u>2,00,000</u>	<u>3,50,000</u>
Total		17,70,000
Less: Outside liabilities and preference share capital		

i. Trade Payables	1,50,000	
ii. 15% debentures	1,20,000	
iii. 12% Preference share capital	<u>2,50,000</u>	<u>(5,20,000)</u>
Assets backing for equity share capital (a-b)		<u>12,50,000</u>
Equity share capital		5,00,000
Asset backing		2.5 times

(B) Dividend Rates:

Dividend rates have been fluctuating in the industry while Hoorey Ltd. has constant dividend rates.

3. Computation of adjusted Normal Rate of Return as applicable to Hoorey Ltd.

Particulars	Asset backing	Dividend rates
Industry standard	2 times	fluctuating
Hoorey Ltd.	2.5 times	constant
Degree of Variance from standard	+25%	N.A.
Impact on risk & consequent adjustment to NRR	↓	↓
Quantum of Adjustment to NRR (assuming 100% variance=1% change)	-0.25%	-0.50% (say)

Adjusted NRR = 15% - 0.25% - 0.50% = 14.25%.

18. 1. Calculation of Target index

	(₹ in lakh)				
Year	20X1-X2	20X2-X3	20X3-X4	20X4-X5	20X5-X6
Employees cost	520	480	450	600	750
Value added	1,100	1,170	960	1,290	1,700
Percentage of 'Employee cost' to 'Value added' (to the nearest whole number)	47%	41%	47%	47%	44%

Target index percentage is taken as least of the above from companies viewpoint on conservative basis i.e. 41%.

2. Value Added Statement for the year 20X6-20X7

	(₹ in lakh)	(₹ in lakh)
Sales		5,970
Less: Cost of bought in goods & services		
Material consumed	1,950	
Production expenses	500	
Administrative expenses	200	
Selling expenses	<u>350</u>	<u>(3,000)</u>
Added value		<u>2,970</u>

3. Employee cost for 20X6-20X7

	(₹ in lakh)
Wages	400
Production salaries	130
Administrative salaries	150
Selling salaries	120
	<u>800</u>

- 4. Calculation of target employee cost** = Target Index Percentage x Value added
= 41% x ₹ 2,970 lakh = ₹ 1217.70 lakh

5. Calculation of savings

Target employee cost	=	₹ 1,217.70 lakh
Less: Actual Cost	=	<u>₹ 800.00 lakh</u>
Saving	=	<u>₹ 417.70 lakh</u>

6. Calculation of Variable incentive for the year 20X6-20X7:

70% of saving is variable incentive = 70% x ₹ 417.70 lakh = ₹ 292.39 lakh.

19. Computation of Economic Value Added

	₹ in lakh
Profit after tax	420
Add: Interest net of tax = $60 \times \left(\frac{100-30}{100} \right)$	<u>42</u>
Return to providers of funds	462
Less: Cost of Capital	<u>(342)</u>
Economic Value Added	<u>120</u>

MVA of ₹ 14005 crore:

The MVA of ₹ 14005 crore is the difference between the current Market Value of LIL and the capital contributed by the fund providers. While EVA measures current earning efficiency of the company, MVA takes into consideration the EVA from not only the assets in place but also from the future projects/activities of the company. The difference between MVA over EVA thus represents the value attributed to the future potential of the company & may change from time to time based on market sentiments. In short the MVA is the net present value of all future EVA's.

Working Notes:

1. Calculation of Net Profit after interest and tax

Interest on Debentures = 50,00,000 units x 10 x 12% = ₹ 60,00,000

Therefore, Financial Leverage = $\frac{\text{Profit before Interest \& taxes (PBIT)}}{\text{PBIT less Interest}}$

$$1.10 = \frac{\text{PBIT}}{\text{PBIT} - ₹ 60,00,000}$$

$$1.10 (\text{PBIT} - ₹ 60,00,000) = \text{PBIT}$$

$$1.10 \text{ PBIT} - ₹ 66,00,000 = \text{PBIT}$$

$$1.10 \text{ PBIT} - \text{PBIT} = ₹ 66,00,000$$

$$0.10 \text{ PBIT} = ₹ 66,00,000$$

$$\text{PBIT} = ₹ 6,60,00,000$$

Profit after interest but before tax = ₹ 6,60,00,000 – ₹ 60,00,000 = ₹ 6,00,00,000

Less: Income Tax @ 30% (₹ 1,80,00,000)

Profit After Interest & Tax ₹ 4,20,00,000

2. Calculation of Weighted Average Cost of Capital (WACC)

	₹ in lakh	Amount (₹) (1)	Weight (2)	Cost% (3)	WACC% (4) = 2x3
Equity Shareholders' fund					
Common Shares	1,582				
Securities Premium	155				
Free Reserves	154				
Capital Reserves	109				
		2,000	0.80	15	12.00

Debentureholders' fund	500	0.20	8.4*	1.68
	2,500	1.00		13.68

$$\begin{aligned}
 \text{Cost of Capital} &= \text{Capital Employed} \times \text{WACC\%} \\
 &= ₹ 2,500 \text{ lakh} \times 13.68\% \\
 &= ₹ 342 \text{ lakh}
 \end{aligned}$$

20.

Capital Base	=	₹ 1,00,00,000
Actual Profit	=	₹ 11,00,000
Target Profit @ 12.5%	=	₹ 12,50,000

$$\begin{aligned}
 \text{Expected Profit on employing the particular executive} \\
 &= ₹ 12,50,000 + ₹ 2,50,000 = ₹ 15,00,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Additional Profit} &= \text{Expected Profit} - \text{Actual Profit} \\
 &= ₹ 15,00,000 - ₹ 11,00,000 = ₹ 4,00,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Maximum bid price} &= \frac{\text{Additional Profit}}{\text{Rate of Return on Investment}} \\
 &= \frac{4,00,000}{12.5} \times 100 = ₹ 32,00,000
 \end{aligned}$$

Maximum salary that can be offered = 12.5% of ₹ 32,00,000 i.e., ₹ 4,00,000

Maximum salary can be offered to that particular executive upto the amount of additional profit i.e., ₹ 4,00,000.

* Rate of interest on debentures is taken net of tax of 30%.